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No. 04 OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

BANK UNITED, BANK UNITED CORP., AND HYPERION PARTNERS L.P.,

Petitioners,

v.

UNITED STATES,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

In *United States* v. *Winstar Corp.*, 518 U.S. 839 (1996), this Court held that contractual capital—the "cash substitute" offered by the government to induce private parties to acquire failing thrifts—is valuable, and that the government is liable under the common law of contracts for the breach of capital promises. In *Mobil Oil Exploration & Producing Southeast, Inc.* v. *United States*, 530 U.S. 604 (2000), this Court held that the Federal Circuit is similarly required to apply the common law of contract remedies in government contract actions. The question presented is:

Did the Federal Circuit err in applying special rules of contract damages, based on the assumption that contractual capital has no value, to relieve the government of financial responsibility for its adjudicated breach of contract in this case?

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

The caption contains the names of all of the parties to the proceeding in the court below.

Pursuant to this Court's Rule 29.6, petitioners state that Washington Mutual, Inc. is the parent or successor corporation of Bank United and Bank United Corp. Petitioners further state that the following entities hold more than a 10% interest in Hyperion Partners L.P.: Prudential Financial, Inc.; American International Group; SBC Master Pension Trust; and Property Asset Management Inc., a subsidiary of Lehman Brothers Holdings Inc.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Bank United, Bank United Corp., and Hyperion Partners L.P. respectfully submit this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-16a), is not officially reported, but is available at 80 Fed. Appx. 663. The opinion of the trial court on remedies (App., *infra*, 17a-61a) is reported at 50 Fed. Cl. 645. A subsequent order on remedies (App., *infra*, 62a-67a) is not reported. The opinion of the trial court on liability (App., *infra*, 68a-77a) is reported at 49 Fed. Cl. 1. A subsequent order on liability (App., *infra*, 78a-80a) is reported at 50 Fed. Cl. 327.

JURISDICTION

The judgment of the court of appeals was entered on September 22, 2003. A timely petition for rehearing was denied on December 12, 2003. App., *infra*, 81a. On February 25, 2004, the Chief Justice extended the time for filing a petition for a writ of certiorari to and including April 10, 2004. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

Petitioners agreed to acquire a failing thrift in exchange for the government's express contractual forbearances and other promises concerning the calculation of regulatory capital. The government breached those promises upon the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), which eliminated most forms of contractual capital. *See United States* v. *Winstar Corp.*, 518 U.S. 839 (1996). After a trial, the Court of

Federal Claims found that petitioners had mitigated the effects of the government's breach by causing additional cash capital to be infused or invested into the thrift to replace the contractual capital lost as a result of the government's breach. Although petitioners incurred more than $100 million in total mitigation costs, the trial court awarded only $8.8 million in transaction costs. The Federal Circuit further reduced that award to $4.9 million.

1. This case arises from the thrift crisis of the 1980s, which previously has been chronicled by this Court in *Winstar*. 518 U.S. at 844-48. "By the end of 1987, over 500 savings institutions were insolvent, including 117 in Texas." App., *infra*, 18a. But the Federal Savings and Loan Insurance Corporation (FSLIC) was also insolvent. *Id.* at 18a-19a. "Realizing that FSLIC lacked the funds to liquidate all of the failing thrifts, the [Federal Home Loan Bank Board (FHLBB)] chose to avoid the insurance liability by encouraging healthy thrifts and outside investors to take over ailing institutions in a series of 'supervisory mergers.'" *Winstar*, 518 U.S. at 847.

In February 1988, the FHLBB introduced the Southwest Plan to induce investors to acquire failing Texas thrifts. App., *infra*, 19a. As this Court has recognized, "[s]uch transactions, in which the acquiring parties assumed the obligations of thrifts with liabilities that far outstripped their assets, were not intrinsically attractive to healthy institutions; nor did FSLIC have sufficient cash to promote such acquisitions through direct subsidies alone, although cash contributions from FSLIC were often part of a transaction." *Winstar*, 518 U.S. at 848. Accordingly, "[t]o attract outside investors, FSLIC made regulatory commitments to potential acquirers" (App., *infra*, 19a)—commitments that functioned as "cash substitute[s]" in the context of supervisory mergers. *Winstar*, 518 U.S. at 850.

United Savings Association of Texas (Old United) was a failed thrift offered by the regulators as part of the Southwest Plan. App., *infra*, 21a. After a "flurry of negotiations," petitioners agreed to take over Old United in exchange for a series of contractual promises from the government. *Id.* at 22a. Petitioners agreed to infuse $200 million of new capital ($90 million in equity and $110 million in subordinated debt) into the thrift, which was eventually renamed Bank United. *Id.* at 23a; *see also id.* at 69a (describing the corporate history of petitioners). In exchange for petitioners' investment and their agreement to assume the obligations of Old United, the government contractually agreed to forbear from enforcing regulatory capital-ratio requirements so long as Bank United complied with a modified capital plan; that the subordinated debt would be treated as equity in computing the bank's capital ratio; and that $30 million of supervisory goodwill created in the transaction would count as regulatory capital for a 25-year amortization period. *Id.* at 24a; *see also id.* at 25a-26a (summarizing the "principal, relevant terms" of the parties' agreement); *id.* at 69a (same).

The agreement benefited petitioners because the net effect was to allow them to operate Bank United pursuant to the negotiated capital requirements rather than the more stringent standards that otherwise would have been applicable. Petitioners intended to use the contractual capital (*i.e.*, the capital-ratio forbearance, subordinated debt, and supervisory goodwill agreements) to grow the bank by investing in profitable assets. App., *infra*, 46a-47a. By providing "borrowing capacity" (leverage), the contractual capital would permit the bank to acquire interest-earning assets funded by low-cost deposits. Petitioners "projected average annual growth of approximately $800 million in various types of assets." *Id.* at 46a. This growth, and the earnings it would generate, would not have been possible without the government's contractual promises. *See id.* at 39a. The leverage promised by the government was thus necessary to give peti-

tioners the opportunity to convert the existing bank into a profitable enterprise. *See Winstar*, 518 U.S. at 924 (Scalia, J., concurring in judgment) (observing that leverage capacity was the "essential bargain" of the contract).

The government also benefited from the agreement with petitioners: As compared to liquidation, the transaction saved FSLIC as much as $700 million. App., *infra*, 26a. The government thus "convert[ed] some of its financial insurance obligations into responsibilities of private entrepreneurs." *Winstar*, 518 U.S. at 894.

Petitioners performed their side of the bargain by infusing $200 million of new capital into Bank United. App., *infra*, 26a. The government, however, failed to keep its word: Less than a year after the transaction was consummated, FIRREA "breached several provisions of the contract between [petitioners] and the government having an impact on calculation of required minimum capital ratios." *Id.* at 26a-27a; *cf. Winstar*, 518 U.S. at 857 ("The impact of FIRREA's new capital requirements . . . was swift and severe"). The principal adverse impacts of FIRREA on petitioners were that Bank United was required to comply with higher capital requirements than provided for in the contract with the government; subordinated debt could no longer be counted as regulatory capital; and supervisory goodwill had to be phased out over just five years. App., *infra*, 27a-28a, 48a.

"The clear, direct and immediate harmful impact of FIRREA upon implementation was significant loss of borrowing capacity . . . . Stated in balance-sheet terms, this immediate loss may be stated as a significant reduction in capital ratio." App., *infra*, 37a. Petitioners lost the ability to leverage the contractual capital into earning assets: Before the breach, Bank United had sufficient capital to hold $11.7 billion in assets, but after the breach it could hold only $3.7 billion. C.A. App. A2000184. "The value of leverage is in the potential for profits . . . . If leverage did not have value, [petition-

ers] would not have bargained for the capital forbearance, subordinated debt and supervisory goodwill provisions." App., *infra*, 38a n.11; *see Winstar*, 518 U.S. at 851 (capital promises "allow[ed] the thrift to leverage more loans (and, it hoped, make more profits)"). As the government acknowledged in *Winstar*, "the leveraging that thrifts were getting was enormous. They could have made enormous profits." Tr. of Oral Arg. in No. 95-865 (U.S. Apr. 24, 1996), at 12.

The government's breach not only prevented petitioners from earning the profits that they (and the government) expected at the time the contract was made, but put Bank United in immediate peril of failing the new FIRREA capital requirements. App., *infra*, 27a-28a. Petitioners took three principal steps to improve the bank's capital position in the wake of the breach. First, the $110 million in subordinated debt at the bank level was exchanged in 1990 for holding company debt, at a higher interest rate. *Id.* at 42a-43a. This allowed the proceeds to be contributed to the bank as regulatory capital after FIRREA abrogated the government's promise that the bank debt would count as regulatory capital. *Id.* at 50a. Second, during 1990 and 1991 petitioners infused approximately $35 million in cash capital into the bank. *Id.* at 64a. Third, in 1992 Bank United issued $85.5 million in preferred stock. *Id.* at 50a.

2. Like a number of other thrift acquirers, petitioners sued the United States for breach of contract under the Tucker Act, 28 U.S.C. § 1491. In *Winstar*, this Court held that the government is liable in contract for FIRREA-based breaches of supervisory merger agreements. *See* 518 U.S. at 919 (Scalia, J., concurring in judgment) ("the contracts at issue in this case gave rise to an obligation on the part of the Government to afford respondents favorable accounting treatment, and [ ] the contracts were broken by the Government's discontinuation of that favorable treatment, as required by FIRREA").

a. The Court of Federal Claims (Smith, J.) granted summary judgment to petitioners on liability, holding that the contractual agreements in this case were not materially different from those considered by this Court in *Winstar*. App., *infra*, 68a-80a. The trial court concluded that petitioners "are entitled to damages that resulted from the need to meet the enhanced capital requirements that they otherwise would not have had to meet had the government honored the capital forbearance promise." *Id.* at 75a.

b. The Court of Federal Claims (Turner, J.) then held a trial on damages. Petitioners' principal claim at trial was for lost profits. *See Glendale Fed. Bank* v. *United States*, 239 F.3d 1374, 1380 (Fed. Cir. 2001) (lost profits are the primary means by which "the law makes the non-breaching party whole"). Petitioners introduced models to establish that the government's breach, by dramatically reducing the bank's leverage, caused them to lose profits of $350 million on an after-tax basis. C.A. App. A1002805-06, A1002831-41; *see* App., *infra*, 30a. The government "elected to counter [petitioners'] case on all fronts, both attacking on the merits their claim of entitlement to lost profits and asserting that any such claim is barred by the doctrine of mitigation of damages." *Id.* at 35a. The trial court did not reach the merits of petitioners' lost-profits claim because it "conclude[d] that [petitioners] could have and, in fact, did mitigate damages potentially flowing from the enactment of FIRREA." *Id.* at 35a-36a.

The trial court recognized that "at the time of FIRREA's impacts, plaintiffs became entitled to the cost of restoring the borrowing capacity (capital ratio) eliminated by FIRREA." App., *infra*, 38a. "In a case of this nature, such damages are the same as the costs of mitigation. *This is the 'make whole' remedy to which [petitioners] were surely entitled.*" *Ibid.* (emphasis added); *see also id.* at 40a ("[petitioners] certainly are entitled to recover the costs they incurred in actually mitigating"); *id.* at 59a ("[petitioners] are entitled to recover

their actual costs incurred in mitigation of the lost leverage capacity caused by FIRREA"). The court then examined the three principal mitigating transactions undertaken by petitioners.

i. The trial court found that petitioners had incurred $4.9 million in costs in connection with the 1990 subordinated debt conversion. App., *infra*, 50a. This amount included $180,000 in legal fees, $1.7 million in interest paid on a bridge loan, and $3 million in "additional interest" paid because the holding company bonds had a higher coupon rate than the bank bonds they were issued to replace. *Id.* at 59a. The trial court found that petitioners "would not have incurred such added interest cost had [the government] not breached," and "conclude[d] that [petitioners] are entitled to recover the *total* costs claimed for mitigating the subordinated-debt impact of the breach." *Ibid.* (emphasis added).

ii. The trial court recognized that petitioners had "further mitigated . . . by various other infusions of capital into Bank United," which totaled approximately $35 million. App., *infra*, 60a. The court acknowledged that petitioners "would have been entitled to any proven costs incurred in connection with these mitigation infusions of capital." *Ibid.*

Nevertheless, the trial court rejected petitioners' contention that they were entitled, as "cover" damages, to a return of the $35 million that they were forced by the breach to infuse into the bank, as well as the earnings they would have made had they been able to deploy this cash capital elsewhere (which petitioners estimated at $57 million). App., *infra*, 65a. The court said that "[t]o award the principal amount of such capital infusions would be replacing an investment [petitioners] still have or have transferred." *Ibid.* As to the lost earnings on the infusions, the court said that the requested award "would be a duplication of whatever return the infusing [petitioners] have already received from their investment." *Ibid.*

iii. The trial court found, as a matter of fact, that the $85.5 million in preferred stock issued in December 1992 was a mitigating transaction that would not have occurred in the absence of the breach. App., *infra*, 59a-60a. The court also found that petitioners were unable to issue equity stock on the capital markets before December 1992. *Id.* at 49a & n.15. For this reason, the parties agreed for purposes of the lost profits claim on a "damages window" between the end of 1989 and the end of 1992. *Id.* at 28a.

The trial court concluded that petitioners were entitled to $4 million in costs associated with the preferred stock transaction, consisting solely of out-of-pocket expenses to lawyers and investment bankers. App., *infra*, 59a-60a. But the court denied petitioners' request for the $69.3 million in dividends Bank United actually paid on the preferred stock through the date of trial. Notwithstanding petitioners' contention that the dividends would not have been incurred in the absence of the breach, and thus were recoverable as mitigation costs, the court ruled that the dividends were not recoverable because they were "not . . . the transaction costs of mitigating damages." *Id.* at 64a. The court said that "[t]he pre[-]FIRREA goodwill on the balance sheet and the forbearances did not, without more, provide any investable asset," such that petitioners "would have to borrow and thus incur interest expense or similar cost of funds[] obligations on any sum so acquired." *Id.* at 65a. The court concluded that "any dividends paid on the preferred stock are analogous to interest which the bank would have incurred had it instead been able to use its pre[-]FIRREA borrowing capacity." *Ibid.*

3. The Federal Circuit (Prost, J., joined by Mayer, C.J., and Dyk, J.) affirmed in part and reversed in part.

a. At the outset, the court of appeals "affirm[ed] the trial court's grant of summary judgment on the issue of liability." App., *infra*, 4a. The court also affirmed the trial court's rejection of petitioners' claim for lost profits on the ground that

they successfully had mitigated the effects of the government's breach. *Id.* at 4a-8a.

b. The court of appeals acknowledged "the well-established principal [*sic*] that a non-breaching party may recover the actual costs of mitigating a breach." App., *infra*, 12a. The court refused to apply this principle, however, to most of the costs incurred by petitioners.

i. The government did not appeal the trial court's award of $4,884,283 in connection with the 1990 subordinated debt conversion, and the judgment in this amount was affirmed. App., *infra*, 16a.

ii. With respect to the cash capital infusions made by petitioners in 1990 and 1991, the court of appeals affirmed the trial court's rejection of petitioners' claim for both the $35 million principal and the lost earnings thereon. App., *infra*, 12a-13a. As to the principal, the court rested its holding on the notion that the contractual capital had no value: "[T]he new capital, insofar as mitigation is concerned, was replacing borrowing capacity, not tangible assets." *Id.* at 13a. On the earnings, which petitioners claimed as expectancy damages, the court said that "the infusions provided Bank United with an additional $35 million that itself could be invested and on which Bank United earned a return. [Petitioners] fail to demonstrate any difference between the rate of return earned on the $35 million that was infused and the rate of return that otherwise would have been earned on alternative investments." *Ibid.*

iii. Finally, with respect to the dividends actually paid on the $85.5 million in preferred stock, the court said that "the true costs of such a transaction are limited to flotation costs." App., *infra,* 14a. The court justified this approach by reference to *California Federal Bank* v. *United States*, 245 F.3d 1342, 1350 (Fed. Cir. 2001) ("*CalFed*"), *cert. denied*, 534 U.S. 1113 (2002), in which the court similarly had premised the denial of dividend damages on the notion that con-

tractual capital has no value in this context. App., *infra*, 14a. The court of appeals then reversed even the award of transaction costs on the ground that the stock issuance occurred on December 29, 1992, two days before closing of the "damages window" constructed for purposes of the lost profits claim. *Id.* at 15a-16a.

4. In summary, the government induced petitioners to acquire a failed thrift by promising contractual capital, thus saving the federal insurance fund a half-billion dollars or more. Less than a year later, the government breached that contract by eliminating more than $100 million in regulatory capital while simultaneously imposing higher capital requirements. The trial court found that petitioners successfully mitigated the effects of the breach by engaging in the three transactions described above, which cost petitioners more than $100 million. But they are left with a judgment for merely $4.9 million. Hence this petition.

REASONS FOR GRANTING THE WRIT

The courts below unjustly and unlawfully failed to compensate petitioners for the full costs they incurred in mitigating the government's breach of contract. These costs include the $35 million that petitioners were forced by the breach to infuse into the thrift, the $57 million that petitioners would have earned had the government not forced them to make that infusion, and the $69.3 million in dividends actually paid on the preferred stock that the thrift was forced by the breach to issue. All of these costs are plainly recoverable under the common law of contracts. The Federal Circuit's contrary conclusion cannot be reconciled with this Court's decisions holding that the government is bound by those common law principles to the same extent as a private party. In addition, the Federal Circuit expressly premised its denial of these routine contract damages on the proposition that "regulatory capital" has no independent value. That holding is directly

contrary to this Court's decision in *Winstar* and must be corrected if this Court's mandate is to have any meaning.

The decision below is only the latest in a series of refusals by the Federal Circuit properly to interpret the government's regulatory capital promises, or to apply the black-letter law of contracts, in *Winstar*-related cases.[1] In these cases, the Federal Circuit consistently has denied standard remedies that would have made private parties whole for the government's breach of *Winstar*-type contracts. In so doing, the Federal Circuit repeatedly has applied special rules to relieve the government of financial liability. While these cases have involved varying claims, they are united by a common

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[1] *See Glendale*, 239 F.3d 1374 (reversing award of restitution notwithstanding undisputed evidence that the government benefited from the transaction); *CalFed*, 245 F.3d 1342 (relying on *Glendale* to reject restitution claim, and also denying recovery of the full cost of raising external capital); *Landmark Land Co.* v. *FDIC*, 256 F.3d 1365 (Fed. Cir. 2001) (denying the bulk of plaintiff's restitution claim); *Castle* v. *United States*, 301 F.3d 1328 (Fed. Cir. 2002) (denying claims for restitution and just compensation), *cert. denied*, 123 S. Ct. 2572 (2003); *Coast Fed. Bank* v. *United States*, 323 F.3d 1035 (Fed. Cir. 2003) (*en banc*) (adopting interpretation of supervisory merger contract that permitted no damages); *LaSalle Talman Bank* v. *United States*, 317 F.3d 1363 (Fed. Cir. 2003) (remanding for recalculation of damages); *Bluebonnet Sav. Bank* v. *United States*, 339 F.3d 1341 (Fed. Cir. 2003) (vacating trial court's award of damages); *Bailey* v. *United States*, 341 F.3d 1342 (Fed. Cir. 2003) (denying damages and just compensation), *cert. pending*, No. 03-1073. In these eight cases alone, the private plaintiffs asserted well-substantiated claims for more than $5.1 *billion* at the trial level, and $2.4 *billion* at the appellate level, yet the final judgments for private plaintiffs amount to a grand total of $21.5 *million*. And there are nearly 100 similar cases pending in the lower courts. As one observer has summarized the Federal Circuit's dismantling of *Winstar*, "[e]ight years after [this Court] said Uncle Sam was on the hook over [the] thrift crisis, few plaintiffs have seen even a penny." *The S&L Payouts that Never Came*, Legal Times (Feb. 16, 2004), at 1.

element: the Federal Circuit's repeated insistence that goodwill and other forms of contractual capital were essentially valueless, such that the loss of contractual capital did not result in compensable harm. That position flatly contradicts *Winstar*.

As the decision below establishes, the Federal Circuit is undoing at the remedies stage what this Court already has decided on liability—*i.e.*, that the government is responsible for the financial consequences of its FIRREA-induced breaches of contract. There is no dispute in this case that the government entered into a *Winstar*-type contract to induce petitioners to acquire a failed thrift. There is no dispute that petitioners performed under that contract, or that the government breached its capital promises upon the enactment of FIRREA. There is no dispute that petitioners were harmed by the breach, that they successfully mitigated the harmful effects of that breach over time, or that their mitigation efforts were reasonable. And there is no dispute that the common law of contracts entitles petitioners to recover the actual costs of these reasonable mitigation efforts. The court of appeals' legal conclusion that petitioners are entitled to only $4.9 million in transaction costs thus squarely presents the question whether special rules apply to the government in *Winstar*-type cases. This case provides an ideal vehicle for this Court to review the lower courts' failure to adhere to the mandate of *Winstar*.

1. The Federal Circuit's failure to award the actual costs of mitigation in this case is fundamentally irreconcilable with this Court's decision in *Winstar*, which confirmed the long-standing rule that "[w]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." 518 U.S. at 895. This principle protects both the government and government contractors by allowing the

government to purchase goods and services without incurring a large risk premium. *Id.* at 913 (Breyer, J., concurring).

In *Winstar*, this Court emphasized the crucial importance of binding the government to the common law of contracts, and, applying those principles, held the government liable in contract for FIRREA's elimination of regulatory capital forbearances. The Court subsequently made clear that these common-law principles similarly govern the remedies available for the government's breach of contract. *Mobil Oil Exploration & Producing Southeast, Inc.* v. *United States*, 530 U.S. 604, 607-08 (2000). Yet, in open defiance of these decisions, the Federal Circuit has chosen to create a unique body of remedies law—in this case, by refusing to award petitioners the actual costs of their mitigating transactions—that serves to shield the government from financial liability in *Winstar*-type cases.

2. The root cause of the lower courts' refusal to apply the common law of contract remedies in *Winstar*-type cases is their continued misapprehension of the role of regulatory capital at the heart of supervisory merger agreements.

The Federal Circuit views contractual capital as mere "borrowing capacity" that can be replaced with cash capital with no economic consequence other than the transaction costs (*i.e.*, fees paid to lawyers and investment bankers). App, *infra*, 10a, 13a-14a; *see also, e.g.*, *CalFed*, 245 F.3d at 1350. If this view were correct, there would have been no thrift crisis: the insolvent thrifts (or the government) could simply have raised more capital. But in the real world, that was not possible. *Winstar*, 518 U.S. at 848. The government chose instead to solve the problem through supervisory mergers and acquisitions, providing contractual capital as a "cash substitute" to induce private parties to take on the government's own financial obligations. *Id.* at 850.

What the Federal Circuit describes as mere "borrowing capacity" is, in reality, the engine that makes thrifts work.

The principal business of a bank is borrowing money from one group (depositors) at a lower rate than the bank can lend it to another group (*e.g.*, home buyers). *See* App., *infra*, 38a n.11 (a bank's "reason for being is to borrow at one rate and lend (or otherwise to invest) at a higher rate"). Capital requirements are a *constraint* on the "borrowing capacity" of a thrift. Contractual capital was regulatory *permission* to borrow more without injecting more cash into the bank. The government contractually committed to this treatment of contractual capital because it expected the thrifts to leverage this capital into productive assets that would generate sufficient profits to ensure future viability. *Winstar*, 518 U.S. at 851.

If there had been no breach, petitioners could have maintained their plans for growing the size of the bank without infusing additional capital into the thrift or obtaining additional capital in the external markets. The fact that petitioners were forced to "replace" the contractual capital with cash capital does not diminish their entitlement to recover the costs of that replacement. "Borrowing capacity," to use the Federal Circuit's phrase, is valuable because of its earnings potential, and it is this value that was destroyed by the breach. By holding that such "borrowing capacity" can be replaced by cash without economic consequence, the Federal Circuit ignored the role that the *Winstar* Court understood regulatory capital to play in the operation of a bank—an understanding that was crucial to the Court's liability holding.

3. The Federal Circuit's legal errors in denying petitioners their costs of mitigation do not concern mere collateral issues, but go to the very foundation of this Court's *Winstar* decision. As this Court recognized, the core of the government's promise in *Winstar*-type contracts was the obtaining of leverage capacity *without the dedication of cash to the bank*. 518 U.S. at 850. Petitioners incurred massive obligations in exchange for the government's express contractual promises freeing them from the need to infuse additional

cash into the bank—promises that were broken shortly after they were made, accepted, and relied upon.

It cannot seriously be contended that petitioners would have paid $200 million to acquire Old United in 1988 if the government had provided $8.8 million (or $4.9 million) in cash rather than the contractual capital promises.[2] Yet that is the fundamental premise of the decisions below. Those decisions cannot be reconciled with law, logic, or common sense. They eviscerate the premise of *Winstar* and create special rules for the government in violation of *Mobil Oil*. This Court should put the Federal Circuit back on the right track to prevent the government from securing a windfall in connection with its breach of supervisory merger contracts. Reinforcing the correct legal interpretation of the government's regulatory capital promises—through this case and at this time—is crucial to the correct resolution of numerous *Winstar*-type cases pending in the lower courts.

I. The Federal Circuit's Refusal To Award Any Costs In Connection With The Cash Infusion Conflicts With Prior Decisions Of This Court

The government provided petitioners with a "cash substitute"—the contractual capital promises—to induce them to acquire Old United. When the government breached the contract and eliminated that substitute, petitioners had to contribute $35 million in actual cash to shore up the bank's regulatory capital position and to make up the shortfall created by the government's breach. Yet the courts below awarded *zero* damages for that transaction. Under a correct application of *Winstar* and *Mobil Oil*, petitioners are entitled to recover

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[2] Petitioners' principals testified without contradiction that they would not have done the deal in the absence of the government's promises regarding contractual capital. C.A. App. A1000263-65; A1000718-20; A1003563-64.

both the $35 million they infused into the thrift and the returns they would have earned had they been able to deploy this capital elsewhere. The Federal Circuit's refusal to make an appropriate award warrants this Court's review.

1. The government's breach immediately reduced Bank United's regulatory capital by more than $100 million. App., *infra*, 8a. Petitioners had only two options to improve the bank's capital ratios and to continue its operations after the breach: shrink the size of the bank or add more capital to the bank. *See, e.g., Glendale*, 239 F.3d at 1377. One of the actions petitioners undertook in the wake of the government's breach was to infuse $35 million of their own cash into the bank. This infusion would have been unnecessary in the absence of the breach, and the trial court correctly found that it constituted a mitigating transaction. App., *infra*, 60a. The Federal Circuit did not disturb that factual finding. *Id.* at 10a-12a. The court of appeals, however, committed manifest legal error in holding as a matter of law that petitioners were not entitled to recover the costs of that transaction.

The $35 million capital infusion was a straightforward "cover" transaction: When the government broke its promise to recognize contractual capital, petitioners put in cash capital instead. At common law, the non-breaching party is always entitled to its costs of cover. *Restatement (Second) of Contracts* § 347, cmt. *c*; *cf.* U.C.C. § 2-712. The courts below rigorously enforced only one-half of the common-law doctrine: that consequential damages or lost profits will not be awarded to the extent that such damages can be avoided or mitigated by the non-breaching party. *Restatement (Second) of Contracts* § 350. They entirely ignored the common-law corollary that, while the law imposes a duty to mitigate, it also ensures that the non-breaching party can recover losses incurred in connection with mitigation. *Id.* § 350, cmt. *h*. None of the three reasons proffered by the court of appeals in refusing to apply this settled principle is valid.

a. In support of its conclusion that petitioners could not recover their capital infusion, the Federal Circuit noted that the contractual capital promised by the government amounted to an intangible asset, whereas the cash capital was a tangible (or "investable") asset once it was infused into the bank. App., *infra*, 10a-11a. But no principle of law requires the non-breaching party to obtain *identical* performance in order to mitigate or cover. To the contrary, it often will be the case (as it was here) that the non-breaching party is forced to obtain a *substitute* for the unique promises broken by the government, in which case the law allows damages for the difference. *Restatement (Second) of Contracts* § 350, cmt. *e*.

Outside the context of the *Winstar* cases, the Federal Circuit has followed the common-law rule to reach results directly contrary to its decision in this case. In *Hughes Communications Galaxy, Inc.* v. *United States*, 271 F.3d 1060 (Fed. Cir. 2001), for example, the government had promised a private company that it could use the space shuttle to launch commercial satellites. Shuttle service, like the contractual capital promises here, was uniquely available from the government. After the space shuttle program was suspended, the private company in *Hughes* was required to use much more expensive rockets to launch its satellites. Notwithstanding the manifest differences between the services promised and the substitute employed in mitigation, the Federal Circuit held that the government was liable for the "difference between the cost of the substitute services and the contract price plus other losses." *Id.* at 1066; *see also Naekel* v. *Department of Transp.*, 850 F.2d 682, 685 (Fed. Cir. 1988).

The Federal Circuit's departure in this case from the common-law rule, as articulated in *Hughes* and other cases, is explicable only as part of its continuing effort to deny recovery to *Winstar* plaintiffs. The differences between contractual capital and cash capital are undisputed; but, in this

context, they are also meaningless. The government's breach deprived petitioners of contractual capital, which was uniquely available from the government itself; in mitigation, petitioners availed themselves of the only lawful substitute, which was cash capital. The essence of the breach effected by FIRREA was that petitioners (and others similarly situated) could no longer rely on intangible assets to meet regulatory capital requirements. To say that petitioners cannot recover mitigation damages because they had to use cash rather than the intangible assets that were outlawed by FIRREA is to turn the government's breach into a defense. Only by applying a special rule for the government, in contravention of *Winstar* and *Mobil Oil*, could the Federal Circuit conclude that the capital infusion is not recoverable as cover damages.

b. The Federal Circuit's second rationale is, if anything, even more wrong than its first. The court said that "*if* the capital infusions replaced funds that would otherwise have been borrowed, they prevented Bank United from incurring a $35 million debt that it would eventually have been required to repay." App., *infra*, 11a (emphasis added). The undisputed evidence, however, was that the capital infusion was *not* made to replace "borrowed funds"; it was made to replace the contractual capital lost as a result of the government's breach. *See id.* at 53a. That capital was used to *support* borrowings, not to retire them.

For a variety of reasons, banks can borrow at lower cost than other corporations. Banks use those borrowings to fund assets (*e.g.*, mortgage loans) that pay higher yields. A bank's principal mechanism for generating profit is the spread between the costs of borrowing and the higher yields on the assets funded.[3] Moreover, because bank deposits are unsecured,

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[3] To be sure, using cash capital rather than contractual capital for leverage saves a small fraction of those borrowing costs. But the reason why regulatory capital is valuable is the ability to leverage it *many times over*. *See Winstar*, 518 U.S. at 851 (citing

the assets funded by those borrowings can be pledged to secure additional liabilities (such as advances from the Federal Home Loan Banks) to fund even more assets.

As this Court explained in *Winstar*, the business of banking is leverage. The regulatory capital requirements operate as a *constraint* on banks' ability to borrow. By providing more contractual capital, the agreement here "inflated the institution's reserves, thereby allowing the thrift to leverage more loans." *Winstar*, 518 U.S. at 851. When the government breached the contract in this case, the injury to petitioners was the *reduction* in Bank United's ability to borrow. For the Federal Circuit to say that petitioners were not harmed because they avoided an opportunity to borrow turns the business of banking on its head.

By studiously ignoring the realities of these transactions and the business milieu in which petitioners operate, the Federal Circuit once again violated the precepts laid down in *Winstar*. This Court took pains to understand and to explain the workings of the thrift industry and the critical role of regulatory capital. 518 U.S. at 849-55. The Federal Circuit, by contrast, recognized that the government's contractual capital promises created "borrowing capacity," but concluded that this ability to leverage—the primary consideration offered by the government to induce petitioners to acquire Bank United—was without value. App., *infra*, 13a. It is precisely that conclusion, however, that this Court repeatedly rejected in *Winstar* itself. 518 U.S. at 907 (observing that the breaking of the government's regulatory capital promises "eliminate[d] virtually all of the consideration provided by

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Breeden, *Thumbs on the Scale: The Role That Accounting Practices Played in the Savings and Loan Crisis*, 59 Fordham L. Rev. S71, S75-S76 (1991)). In this case, the Federal Circuit acknowledged that the funding cost difference between using cash and contractual capital was immaterial. App., *infra*, 11a.

the Government in these transactions"); *id.* at 921 (Scalia, J., concurring in judgment) (stating that failing to recognize the value of contractual capital to the bank would render the government's promises in these supervisory merger agreements "illusory"); *see also RTC* v. *FSLIC*, 25 F.3d 1493, 1502 (10th Cir. 1994) (finding that "no rational investor" would have entered into a *Winstar*-type contract without the regulatory capital promises).

c. The Federal Circuit's final rationale is completely baseless. The court said that petitioners still had the capital infusion, just in a different "account" (*i.e.*, in the bank rather than in their pockets). *See* App., *infra*, 11a-12a. That analysis ignores the indisputable fact that absent the breach they would have had *both* the contractual capital and the cash capital. Again, the lower courts' analysis assumes that regulatory capital had no independent value to the bank—a conclusion that cannot be squared with this Court's decision in *Winstar*.

In contrast to the decisions below, the Ninth Circuit has recognized that the mere fact that a cash infusion is retained in the bank does not make the investors whole. *See Far West Fed. Bank* v. *OTS*, 119 F.3d 1358, 1366 (9th Cir. 1997). Instead, the Ninth Circuit upheld an award of the entire cash infusion. *Ibid.*; *see also Bluebonnet Sav. Bank v. United States*, 266 F.3d 1348, 1356 (Fed. Cir. 2001). The decision below cannot be reconciled with this line of authority.

Moreover, petitioners could not take their capital out of the bank without shrinking it—precisely the consequence that the contract would have allowed them to avoid. *Glendale*, 239 F.3d at 1377. Accordingly, the Federal Circuit's assertion that petitioners did not lose control of the $35 million in any sense is inconsistent with the nature of a regulatory capital contract. Putting petitioners in as good a position as they would have occupied in the absence of the breach requires a return of the $35 million capital infusion.

2. The Federal Circuit also committed manifest legal error in concluding that petitioners are not entitled to the foregone earnings on the $35 million they infused into the thrift to mitigate the government's breach. The Federal Circuit denied petitioners any earnings on the capital infusion into the bank because petitioners "fail[ed] to demonstrate any difference between the rate of return earned on the $35 million that was infused and the rate of return that otherwise would have been earned on alternative investments." App., *infra*, 13a. This conclusion is nothing more than a legal holding that the contractual capital had no value, and thus cannot be reconciled with *Winstar*.

In the absence of the breach, petitioners would have had this capital available for other purposes—investing in the market, in government bonds, in other opportunities, or in the thrift itself. The thrift would have made as much as it actually did *and* petitioners would have had the earnings on the $35 million. Accordingly, the correct measure of damages is the difference between the return earned on the $35 million actually infused into the bank due to the breach, on the one hand, and both the bank's actual return and the returns petitioners would have earned had they been able to deploy their $35 million elsewhere, on the other. *Restatement (Second) of Contracts* § 347, cmt. *f*. Putting petitioners in the position they would have occupied in the absence of the breach thus requires awarding them the earnings on the $35 million.

3. The Federal Circuit's denial of any damages in connection with the capital infusion creates an anomaly in the law of contract remedies. If petitioners had not infused the capital and instead sold assets to remain in capital compliance, they would have been entitled to the lost earnings on those assets *and* the earnings on the cash that they had retained. *CalFed*, 245 F.3d at 1349-50. It is surpassingly odd that a party that successfully mitigates could be entitled to *less* relief (from both its mitigation and damages awarded to

reimburse the costs of that mitigation) than a party that is unable to do so. Unsurprisingly, the law is not so irrational: While the non-breaching party has a duty to mitigate, he is also entitled to the reasonable costs of mitigation. *Restatement (Second) of Contracts* § 350 & cmts. *e*, *h*. The Federal Circuit, by contrast, denied petitioners lost profits on the ground of mitigation *and* denied the costs of that very mitigation, leaving them with no remedy in the face of an adjudicated breach of contract. The inconsistency of that conclusion with the holding and rationale of *Winstar* and *Mobil Oil* warrants review and reversal.

II. The Federal Circuit's Refusal To Award Any Costs In Connection With The Preferred Stock Issuance Conflicts With Prior Decisions Of This Court

The Federal Circuit also erred by refusing to award petitioners the costs of raising capital in the external markets. Bank United raised $85.5 million in capital through the issuance of 3.4 million shares of preferred stock. App., *infra*, 59a. The Federal Circuit, however, persisted in its legal misinterpretation of the government's regulatory capital promises and refused to grant Bank United the *actual costs* of this preferred stock issuance—*i.e.*, the dividends paid to investors that would not have been paid in the absence of the breach. This is an important and recurring issue that warrants review.

1. The trial court recognized that the 1992 preferred stock issuance was a mitigating transaction and awarded petitioners $3,942,500 in commissions, attorneys fees, and other transaction costs incurred in connection with that issuance. App., *infra*, 59a. But the courts below committed legal error in refusing to award petitioners, in addition to those transaction costs, the $69.3 million in dividends actually paid on the preferred stock that Bank United was forced to issue as a result of the government's breach.

a. In *CalFed*, the Federal Circuit similarly denied recovery of dividends paid on preferred stock issued in the wake of the government's breach of capital promises. 245 F.3d at 1350. The Federal Circuit cast its decision there as deference to the trial court's credibility assessment of competing testimony (*ibid.*), and the government subsequently contended that "faulting the trial court for crediting the government's expert regarding replacement costs" is "a matter that does not warrant this Court's attention." Opp. to Pet. for Cert. in No. 01-595 (U.S. Dec. 2001), at 30. The decisions below give the lie to that characterization: the trial court in this case made no credibility assessment or fact-specific determination in denying dividends as damages. App., *infra*, 59a-60a, 63a-64a. Rather, the court held that dividends did not constitute damages as a matter of law because they were "not . . . transaction costs." *Id.* at 64a. In affirming the trial court's judgment, the Federal Circuit reflexively cited its prior decision in *CalFed* and engaged in no further legal analysis. App., *infra*, 14a.[4] Whatever the original basis for that decision, the Federal Circuit now has construed *CalFed* as establishing a legal bar on the award of dividends on equity securities as contract damages. This legal bar, however, is itself legally erroneous.

The Federal Circuit's legal prohibition on the recovery of dividend obligations incurred in the replacement of contractual capital is premised on examining only a single point in time—the day the securities are issued. On the date of issuance, the Federal Circuit said, "the value of the cash pro-

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[4] The court of appeals did note that the testimony of a government expert was "consistent with" awarding only transaction costs. App., *infra*, 14a. But the trial court did not rely on the testimony of this (or any other) witness in denying recovery of preferred stock dividends. App., *infra*, 59a-60a, 64a-65a. Unlike the government's opportunistic and erroneous characterization of *CalFed*, therefore, this case does not involve credibility determinations or conflicting testimony.

ceeds of a capital offering equal[s] the expected expense of future dividends." App., *infra*, 14a. But this approach to calculating damages is contrary to well-established law. Damages are to be measured over the time for contractual performance. *Energy Capital Corp.* v. *United States*, 302 F.3d 1314, 1330 (Fed. Cir. 2002); *cf. Sinclair Ref. Co.* v. *Jenkins Petroleum Process Co.*, 289 U.S. 689, 698 (1933).

Looking back on the stream of payments made by Bank United over the course of the contract, dividends are a cost, plain and simple. If the government had kept its capital promises, Bank United would not have had to issue the preferred stock, and would not have paid $69.3 million in dividends to the new investors. These dividend payments reduced petitioners' earnings on the leverage capacity the new capital was raised to maintain, and they are entitled to recover those payments, which would not have been made in the absence of the breach, as mitigation costs. Any other conclusion cannot be reconciled with *Winstar*'s recognition that the ability to leverage contractual capital was the *sine qua non* of the parties' agreement. *See* 518 U.S. at 921 (Scalia, J., concurring in judgment).

b. The incorrectness of the legal rule applied by the courts below is demonstrated by the facts of this very case. Due to the breach, Bank United was forced to convert subordinated debt into a form that would count as regulatory capital under FIRREA, increasing the coupon rate on that debt from 15% to 15.75%. App., *infra*, 42a-43a. The Federal Circuit's decision properly allowed petitioners to recover the increased costs of *debt* financing. App., *infra*, 59a. Under the rationale of the Federal Circuit, petitioners would have been entitled to all interest payments if the holding company had raised $88.5 million by issuing additional subordinated debt, instead of preferred stock issued at the bank level.

Preferred stock functions like a debt instrument in regards to its effect on the issuer's cash flows. Brealey &

Myers, *Principles of Corporate Finance* 392 (6th ed. 2000).[5] Accordingly, this Court and other courts of appeals have recognized that there is no reasonable basis for distinguishing between the costs of debt and equity financing—that is, interest and dividends. *Duquesne Light Co.* v. *Barasch*, 488 U.S. 299, 312 n.7 (1989) (recognizing a method for determining the cost of capital for public utilities that treated debt and equity financing identically); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *City of Los Angeles* v. *United States Dep't of Transp.*, 165 F.3d 972, 979 (D.C. Cir. 1999); *Guaranty Nat'l Ins. Co.* v. *Gates*, 916 F.2d 508, 515 (9th Cir. 1990); *Consolidated Rail Corp.* v. *United States*, 619 F.2d 988, 997 (3d Cir. 1980). The artificial distinction drawn by the Federal Circuit between debt and equity financing cannot be reconciled with these decisions.

Indeed, the Federal Circuit itself has recognized elsewhere that the costs of an equity issuance to raise replacement capital are more than the transaction costs. In *Bluebonnet*, the government's breach of a *Winstar*-type contract increased the risk of investing in the bank sufficiently to foreclose an equity issuance and to force the bank to raise capital through a complex debt transaction. 266 F.3d at 1356. The bank argued that its interest costs in the debt transactions were greater than the dividend costs of equity financing it could have obtained but for the breach. *Ibid.* By awarding the increased financing costs, the Federal Circuit necessarily determined that dividend and interest payments are indistinguishable for the purposes of calculating damages. The Federal Circuit's decision here turns that principle on its head.

The decision below also directly conflicts with the Federal Circuit's opinion in *LaSalle*, where the bank sought the

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[5] To raise capital to mitigate the effects of the government's breach, petitioners promised to (and did) pay "interest" (dividends) to public investors at a rate of 10.12% annually.

dividends paid on external replacement capital in the wake of FIRREA. 317 F.3d at 1374. The government offered an identical response, claiming that the $300 million capital raise "had 'no cost' because 'the firm receives cash worth $300 million,' which is 'the full value of the promise it is selling.'" *Ibid.* The Federal Circuit firmly rejected this argument, holding that "capital is not 'costless' to either the investor or the recipient." *Ibid.*

The differing approaches taken in *LaSalle* and *Bluebonnet*, on the one hand, and in *CalFed* and the decision below, on the other, demonstrate that the Federal Circuit itself is deeply and fundamentally confused about "replacement" capital and how to award damages for mitigating transactions.[6] But this issue is critical because replacement is often at issue in *Winstar* cases. As the law now stands in the Federal Circuit, there is an inherent arbitrariness in whether plaintiffs that successfully mitigated a FIRREA breach will recover all, some, or none of the financing costs incurred. The court of appeals, however, has denied rehearing in virtually every *Winstar* case, including this one, notwithstanding these conflicts, and because of the exclusive jurisdiction conferred by the Tucker Act the issue is unlikely to arise in other circuits. This Court should therefore grant certiorari to resolve this important and recurring issue.

2. The government will undoubtedly attempt to deflect attention from the Federal Circuit's deeply flawed refusal to allow recovery of dividend payments by reference to the court's unsupported, and insupportable, conclusion that the 1992 preferred stock issuance was not a mitigating transaction. App., *infra*, 15a-16a. The sole basis for the Federal Circuit's conclusion was that the preferred stock was issued near

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[6] The government has acknowledged that *LaSalle* and *CalFed* are "incompatible." Pet. for Reh'g in Nos. 00-5005 & 00-5027 (Fed. Cir. Feb. 28, 2003), at 8-9.

the end of the "damages window" to which the parties had agreed in connection with this litigation. *Ibid.*

The importance of the "damages window" was that it measured the time that *lost profits* were potentially available *before* petitioners were able fully to mitigate the adverse effects of the breach. Petitioners were able to convert the subordinated debt and to infuse additional capital relatively early, but the undisputed evidence established (and the trial court found) that the external capital markets were closed to thrifts, including Bank United, until the end of 1992. App., *infra*, 49a & n.15; *see also LaSalle*, 317 F.3d at 1368; *Bluebonnet*, 266 F.3d at 1356. When investors again became willing to invest in the thrift industry, Bank United issued the preferred stock, thus completing its mitigation efforts. The "damages window"—an artificial construct to which the parties agreed solely in the context of petitioners' claim for lost profits—thus closed at the end of 1992 *precisely because* of the preferred stock issuance. *See* App., *infra*, 28a. The Federal Circuit's conclusion that this transaction was not made in mitigation of the breach ignores this undisputed record evidence and is contrary to law, logic, and common sense.[7]

III. The Issues Presented By This Case Warrant Review

The Federal Circuit has embarked on a systematic evisceration of *Winstar* plaintiffs' right to contractual remedies—rights this Court held in *Winstar*, and reiterated in *Mobil Oil*, should be governed by the law applicable to all contracting parties. The Federal Circuit has created special rules limiting

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[7] As the trial court recognized, Bank United had a long-term growth plan that was conditioned on the availability of the promised regulatory capital. App., *infra*, 38a. The government's breach created a substantial capital shortfall that disrupted that plan. Bank United raised capital when the markets reopened to cure an existing shortfall and to continue implementation of its pre-breach plan, not to embark on some new enterprise. *Id.* at 49a-50a, 53a-54a.

the economic consequences of the government's breach to the transaction costs of raising replacement capital and deeming the government's regulatory capital promises to be worthless. Those rules render *Winstar* itself all but a nullity, and cannot be reconciled with *Mobil Oil*'s directive to adhere to the *Restatement*'s principles of contract remedies. Review is warranted to effectuate this Court's mandate.

This Court has frequently granted review of cases within the Federal Circuit's exclusive jurisdiction over breach of contract claims against the government, recognizing that a conflict among the circuits may never arise, where the Federal Circuit has departed from the accepted course. *See, e.g.*, *Hercules, Inc.* v. *United States*, 516 U.S. 417 (1996) (resolving whether government contractor could recover tort judgments incurred in the course of performing the contract from the government); *Keene Corp.* v. *United States*, 508 U.S. 200, 205-06 (1993) (granting certiorari to interpret 28 U.S.C. § 1500, which exclusively concerns the jurisdiction of the Court of Federal Claims). Under such circumstances, this Court has focused on the importance of the issue at stake in the case in determining whether review is warranted. *See* Stern & Gressman, *Supreme Court Practice* § 4.21 at 264-65 (8th ed. 2002).[8]

In *Winstar* itself, there was no conflict among the courts of appeals. Instead, the Court granted certiorari "to consider the extent to which special rules, not generally applicable to private contracts, govern enforcement of the governmental contracts at issue here." 518 U.S. at 860. The *Winstar* Court

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[8] The government acknowledged in the court below that "[m]any of the issues addressed" by the Federal Circuit in this case "have ramifications for the other *Winstar*-related cases," and in particular that the Federal Circuit's "discussion of 'mitigation' principles, as they apply to these cases, has broad application." Mot. for Reiss. in Nos. 02-5132 & 02-5127 (Fed. Cir. Nov. 21, 2003), at 2.

held that the government could not rely on such special *liability* rules, and the *Mobil Oil* Court extended that principle to contract *remedies*. But the Federal Circuit's acceptance of special rules to protect the government from bearing the cost of its FIRREA-related breaches has emptied this Court's mandate of any meaning.

At the heart of the Federal Circuit's decision denying standard contractual remedies in this case—like its decisions in other *Winstar*-related cases (*see* note 1, *supra*)—is a fundamental misapprehension of the importance of the government's contractual capital promises. By holding that a regulatory capital forbearance has no independent value—notwithstanding the often hundreds of millions of dollars in net liabilities that the *Winstar* plaintiffs undertook in exchange for the government's promises—the Federal Circuit has contradicted this Court's analysis of the government's regulatory capital promises in *Winstar* and has left private parties, to whom this Court has held the government is liable, without a meaningful remedy. The court of appeals has refused to adhere to *Mobil Oil* in *Winstar* cases, and has gone so far off the track in adjudicating *Winstar* remedies that this Court's further guidance is warranted.

This Court already has recognized that the government is contractually obligated to compensate those parties for breaching its capital promises. *See Winstar*, 518 U.S. at 883. The Federal Circuit, however, has repeatedly refused to apply the standard rules of contractual damages in *Winstar*-type cases, leaving petitioners and others without a meaningful remedy. By relieving the government of the financial consequences of its actions, the court of appeals has effectively transferred massive obligations from the public fisc to private parties—ironically, the very parties who previously volunteered to *help* the government in its time of need. *Ibid.*

The costs imposed on these petitioners by the government's adjudicated breach of contract were more than $100

million. Yet all they have is a judgment for $4.9 million—less than the legal fees incurred in prosecuting their claim. Neither justice nor right has been served in this case. This Court's intervention is urgently needed to prevent the government from benefiting from the consequences of its own breach, and to restore the rule of law in this area.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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April 9, 2004.

APPENDIX

APPENDIX A

United States Court of Appeals,
Federal Circuit

BANK UNITED, Bank United Corp., And Hyperion Partners L.P.,

Plaintiffs-Appellants,

v. Nos. 02-5132, 02-5137

UNITED STATES

Defendant-Cross Appellant. Decided: Sept. 22, 2003

Rehearing and Rehearing En Banc Denied Dec. 12, 2003.

Before MAYER, Chief Judge, DYK, and PROST, Circuit Judges.

PROST, Circuit Judge.

Hyperion Partners L.P. and Bank United Corp. (collectively "Hyperion"), and Bank United appeal the decision of the United States Court of Federal Claims granting them only part of the damages they sought for the government's breach of several agreements caused by the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") Pub. L. No. 101-783, 103 Stat. 183 (1989). *Bank United of Tex. FSB v. United States,* 50 Fed. Cl. 645, 646-50 (2001) ("*Bank United II*"). The United States cross-appeals a portion of the trial court's damages award as well as its interpretation of a regulatory forbearance agreement which formed the basis for its grant of summary judgment as to liability. *Bank United of Tex. FSB v. United*

States, 49 Fed. Cl. 1 (1999), *modification denied,* 50 Fed. Cl. 327 (1999), ("*Bank United I*"). Because we conclude that the trial court correctly interpreted the forbearance agreement, we affirm the grant of summary judgment as to liability. However, because we hold that the trial court failed to sufficiently explain the basis for the portion of its damages award challenged by the government, we reverse the trial court's award of damages as to $3,942,500. Accordingly, we *affirm-in-part*, and *reverse-in-part.*

I. CONTRACT INTERPRETATION

As an initial matter, the government contends that the trial court erred in its interpretation of the capital forbearance agreement. The provision at issue provides, in relevant part, that:

> The FSLIC will forbear, for a period of ten years following the date of consummation of the acquisition ("Effective Date"), from exercising its authority to take action under Section 563.13 . . . for any failure of the Resulting Institution to meet the regulatory capital requirements arising solely from: . . . (c) the assumption of the liabilities of the Acquired Institution as of the Effective Date; . . . or (2) [Bank United's] assumption of the Acquired Institution's regulatory capital deficiency as of the Effective Date; *provided that*, [Bank United] maintains a ratio of regulatory capital to total liabilities at a level no less than [prescribed by the Capital Plan].

Interpreting this provision, the trial court concluded that, once Bank United assumed the liabilities of the "Acquired Institution," the forbearance agreement obligated the government to forbear from enforcing its regulatory capital regulations so long as Bank United remained in compliance with the lower capital ratios set forth by the Capital Plan. *Bank United I,* 49 Fed. Cl. at 5. The trial court explained that, "[s]ince the forbearances . . . were designed to enable Bank United to survive the absorption of the liabilities of [the Acquired Institution], it seems apparent that the modified capital standards in the [Capital Plan] are operative at all times, and

require no separate showing." *Id.* Thus, the trial court held that the forbearance agreement "permitted [Bank United] to meet modified capital requirements in lieu of regulatory capital requirements, for a period of ten years." 50 Fed. Cl. at 327.

On appeal, the government argues that Bank United's assumption of the liabilities of the Acquired Institution did not entitle it to operate under the lower capital ratios set forth by the Capital Plan. Rather, according to the government, the agreement provided that Bank United could operate under the Capital Plan's minimum ratios only during the period between the Effective Date of the transaction and the placement of the $110 million of subordinated debt. Thereafter, argues the government, the capital ratios set forth by the Capital Plan should be read as coming into effect only upon the occurrence of the "triggering events" listed in the agreement. Thus, under the government's interpretation, Bank United's "assumption of the Acquired Institution's regulatory capital deficiency" triggered the government's obligation to forbear. However, once Bank United came into compliance with the generally-applicable regulatory capital requirements upon issuance of the subordinated debt, "its failure to meet the regulatory capital requirements due to its assumption of [the Acquired Institution's] regulatory capital deficiency was erased," thereby deactivating the Capital Plan and requiring Bank United to comply with the generally-applicable regulatory capital requirements unless the Capital Plan was again "triggered."

Hyperion and Bank United respond that both the language and structure of the agreement support the trial court's interpretation. According to Appellants, Bank United's assumption of nearly $5 billion in liabilities as part of the acquisition triggered the forbearance, allowing Bank United to operate under the Capital Plan's lower ratios during the forbearance period. Hyperion and Bank further point out that the modified capital ratios were incorporated into related "Regulatory Capital Maintenance Agreement" which defines the "Capital Plan Level" as "[t]he level at which [Bank

United] is required to maintain its Regulatory Capital pursuant to paragraph one of the forbearance letter." Finally, Hyperion and Bank United contend that the trial court's interpretation is further supported by the interpretation of the parties as evidenced by Bank United's reporting of its compliance with the Capital Plan rather than the higher generally-applicable capital ratio requirements.

We agree with the trial court to the extent it held that the minimum ratios of the Capital Plan continued to be operative after the issuance of the subordinated debt, and we reject the government's proffered alternative interpretation under which the Capital Plan is "triggered" and then deactivated by the subordinated debt issuance. Giving the language of the agreement its ordinary meaning and reading the agreement in its entirety, we conclude that the trial court correctly held that the forbearance continued after the issuance of the subordinated debt. There is no suggestion here that transactions occurring after the initial acquisition caused the bank to be out of compliance, although such events might have eliminated the forbearance. The transaction upon which the government relies—the issuance of the subordinated debt—was not an event that caused the bank to be out of compliance, but rather an event that increased the bank's regulatory capital. The conflict that the government perceives between affording a 10-year term to the regulatory forbearance and the provisions granting forbearance solely on account of the acquisition transaction simply do not exist on the facts of this case. Accordingly, we affirm the trial court's grant of summary judgment on the issue of liability.

II. LOST PROFITS

"One way the law makes the non-breaching party whole is to give him the benefits he expected to receive had the breach not occurred." *Glendale Fed. Bank, FSB v. United States,* 239 F.3d 1374, 1380 (Fed. Cir. 2001) (citing Restatement (Second) of Contracts § 344(a) (1981)). "The benefits that were expected from the contract, 'expectancy damages,' are often equated with lost profits, although they

can include other damage elements as well." *Id.* (citing Restatement (Second) of Contracts § 347 (1981)).

At trial, Hyperion and Bank United argued that they were entitled to expectancy damages of either $558 million or $96 million as measured by two alternative models of lost profits. Both models purported to measure the profits that Bank United would have made by investing the "leverage capacity" it would have enjoyed absent the government's breaches.

The trial court rejected Appellants' lost profits claims, finding that the capital infusions from Hyperion allowed Bank United to prevent the government's breach from negatively affecting its growth or, by extension, its profits. *Bank United II,* 50 Fed. Cl. at 654 (Appellants "could have and, in fact, did mitigate [the] damages potentially flowing from the enactment of FIRREA."); *id.* at 662 ("We find that not only could plaintiffs have easily mitigated the loss of leverage capacity, they actually did so."). This conclusion was based in part on two findings by the trial court.

First, the trial court found that "[d]uring the damages window, the breach impacts did not prevent Bank United from successfully pursuing its forecasted business operations, including retail growth supplemented by wholesale purchases." *Id.* at 662. The trial court reached this conclusion by comparing the predicted growth strategy reflected in Bank United's pre-breach business plans to Bank United's actual performance. Contrary to the rapid wholesale growth reflected in Appellants' lost profits models, the trial court found that Bank United's pre-FIRREA business plans "projected a well-capitalized thrift primarily focusing on retail growth supplemented by wholesale purchases." *Id.* at 659; *id.* at 660 ("The contemporaneous evidence indicates that Bank United pursued a plan, first expressed in the [December 1988 Holding Company Application] and never contradicted in any subsequent business plan, nor by the actual bank, to first grow its retail base and to supplement its growth with wholesale purchases."). Thus, the court concluded that Bank United's pre-FIRREA plans were not consistent with the ag-

gressive wholesale strategy reflected in Appellants' lost profits models. Further, the trial court found that Bank United's actual growth was consistent with its pre-FIRREA plans, indicating that the effects of the breach were fully mitigated. *Id.* at 662.

Second, the trial court found that "Bank United had the financial ability to increase its wholesale assets during the damages window but determined that appropriate purchases were not available." *Id.* Thus, the trial court found that the assumption inherent in both lost profits models that Bank United would have invested its leverage capacity in wholesale assets was undercut by Bank United's actual failure to do so. *Id.* at 662 ("Thus, even though Bank United had the ability to pursue more investments, including wholesale investments, than it actually did, there were frequently no assets in the market that satisfied its risk and yield criteria."); *see also id.* at 663 ("Even though Bank United needed to deploy excess liquidity to maximize income, it was often unable to do so because there was a 'lack of high quality assets' available in the market.") (citation omitted).

On appeal, Hyperion and Bank United contend that the trial court's conclusion that Bank United would not have used its leverage capacity to engage in extensive wholesale growth absent the government's breach is clearly erroneous. Appellants point to two supposed flaws in the evidence supporting the trial court's finding. First, they claim that "the business plans and projections on which the trial court relied are essentially useless in answering the question of how much Bank United would have grown absent the breach." This is so, they argue, because one of the business plans relied on by the trial court was based on incomplete information about the thrift operation being acquired and the remainder were prepared under the threat of the government's breach and therefore do not accurately reflect how Bank United was expected to grow in the absence of the breach. Second, Appellants argue that the trial court misinterpreted isolated evidence that Bank United was occasionally underleveraged, leading it to reach the erroneous conclusion that

this was a persistent problem caused by Bank United's inability to find suitable wholesale assets.

With respect to Appellants' argument that the business plans relied on by the trial court do not accurately reflect how Bank United would have grown in the absence of the breach, we note that testimony was offered at trial supporting the general proposition that business plans submitted as part of the regulatory process accurately reflect the manner in which managers intend to operate their thrifts. Moreover, although Appellants assert that "[t]he December 1988 business plan was prepared before an agreement was reached on the capital promises and was based on limited information about the thrift operation being acquired," they do not identify any specific inaccuracies in the business plan that would render the trial court's reliance on the plan clear error. Similarly, Appellants claim that the remaining business plans relied on by the trial court were prepared under the threat of the government's breach, but fail to cite any evidence specifically supporting their assertion. The record, however, contains testimony and other evidence indicating that as late as mid-1989, Bank United's managers expected that the government would honor the regulatory forbearances and that various projections and other documents were prepared based on that expectation. In light of this evidence and of the record evidence as a whole, we cannot conclude that it was clearly erroneous for the trial court to find that Bank United's pre-FIRREA business plans and projections accurately reflected the pre-breach thrift's expected growth and manner of operation.

As for the contention that the trial court erred in its conclusion that Bank United was often underleveraged during the damages window, Appellants in effect ask this court to re-weigh evidence presented to the trial court and reach a different interpretation. Appellants do not contest the fact that Bank United's officers and managers referred to Bank United as underleveraged or having excess liquidity on various occasions, but rather claim that the "trial court ignored the evidence explaining the Bank's occasional underleveraged posi-

tion." We decline to draw our own inferences regarding the extent of Bank United's underleveraged position from the record evidence. Thus, we conclude that the trial court did not clearly err in finding that Bank United was underleveraged for significant periods of time between 1989 and 1992.

Having rejected Appellants' specific challenges to the trial court's factual findings, we similarly reject the contention that the trial court was clearly erroneous in its conclusion that Bank United successfully mitigated the effects of the government's breach through capital infusions from Hyperion. *Bank United II,* 50 Fed. Cl. at 662. Accordingly, we hold that the trial court did not err in declining to award damages based on the lost profits models presented at trial. Moreover, because the trial court's finding regarding mitigation fully supports its decision not to award expectancy damages, we find it unnecessary to address Appellants' further arguments with respect to lost profits.

III. COST-OF-SUBSTITUTE CAPITAL

Hyperion and Bank United next argue that the trial court erred in rejecting their claim for mitigation damages in the amount of $117 million. This amount is based on Appellants' "cost-of-substitute-capital" model. This model assumes that Bank United would have needed to raise approximately $228 million dollars in December 1989 to mitigate the loss of leverage capacity caused by the government's breach. *Bank United II,* 50 Fed. Cl. at 655.

The trial court rejected this model, explaining that "the most serious flaw in this model is its assumption that all of the lost ratio would have to be restored immediately in December 1989 to forestall economic harm." *Id.* "But an immediate infusion was not required to mitigate," continued the trial court, because mitigation "could have been accomplished, as it was, on a piecemeal basis as and when it appeared to be desirable to take advantage of investment opportunities." *Id.*

On appeal, Hyperion and Bank United challenge the trial court's reasoning, contending that the "piecemeal approach,

which supported Bank United's actual post-breach operations, would have been totally inadequate to mitigate the lost profits from the substantial additional wholesale growth that the Government's breach prevented." Thus, argue Appellants, mitigation of the lost profits that would have been earned by investing its leverage capacity would have required that the lost capacity be immediately restored in full after the breach.

Appellants' arguments regarding their cost-of-replacement-capital model depend on a premise that we have already concluded was correctly rejected by the trial court. The cost-of-replacement-capital model purports to calculate the hypothetical costs of mitigating the profits that Bank United would have earned by investing the leverage capacity it would have had absent the government's breach. As explained above, however, the trial court properly rejected this theory of lost profits, concluding that capital infusions from Hyperion allowed Bank United to invest in wholesale assets in the same manner and to the same extent that it would have absent the breach. In short, Appellants seek the hypothetical costs of mitigating lost profits that the trial court correctly determined were not, in fact, "lost" at all. Thus, because we have concluded that the trial court did not clearly err in finding that Bank United would not in fact have earned these purportedly-lost profits absent the government's breach, it necessarily follows that the trial court's denial of the hypothetical costs of mitigating such profits cannot have been clear error.

IV. MITIGATION DAMAGES

Hyperion and Bank United next argue that the trial court erred in denying their post-trial motions. They contend that the trial court erred by: 1) not awarding them $35,338,988 that was infused into Bank United as equity during 1990 and 1991; 2) refusing to award them $57,074,034 in damages representing a 20 percent rate of return on the $35,338,988 that was infused; and 3) declining to award them $54,126,972 in dividend payments made on the preferred stock issued by Bank United in 1992.

A.

In explaining its calculation of damages, the trial court began by stating that "Plaintiffs are entitled to recover their actual costs incurred in mitigation of the lost leverage capacity caused by FIRREA." *Bank United II,* 50 Fed. Cl. at 665. The trial court went on to find that Appellants would have been entitled to the "proven costs" of Hyperion's infusing more than $35 million into Bank United but that no costs associated with the infusions had been demonstrated. *Id.*

In post-trial motions, Hyperion and Bank United argued that the trial court's finding that the capital infusions were mitigating transactions entitled them to recover the $35 million that was infused. The trial court rejected Appellants' argument, explaining at length that:

> It's important to keep in mind as the starting point of the analysis concerning Plaintiffs' motions that the portion of the bank's capital ratio provided by the supervisory goodwill, and by the forbearances which Bank United lost upon the enactment of FIRREA, represented borrowing capacity. The FIRREA breach did not remove one dime of tangible investable money from the asset side of the bank's balance sheet, . . . The new capital, insofar as mitigation is concerned, was replacing borrowing capacity, not tangible assets.

The trial court further emphasized this distinction between "assets" and "borrowing capacity" by stating that the capital infusions "not only restored borrowing capacity, but provided that much cash for the bank's growth." In other words, the infusion of these funds not only replaced lost leverage capacity, but also resulted in a net increase in the assets of Bank United in the amount of $35 million. Accordingly, the trial court concluded that "[t]o award the principal amount of such capital infusions would be replacing an investment Plaintiffs still have or have transferred."

On appeal, Hyperion and Bank United contend that even if the trial court was correct in concluding that the capital infusions conferred benefits on Bank United beyond the miti-

gation of lost leverage capacity, such benefits were both "incidental" and unwanted and therefore should be ignored in calculating mitigation damages. In addressing the distinction drawn by the trial court between the restoration of borrowing capacity and the addition of assets to Bank United, Appellants concede that "[i]t is true that the payment of $35,338,988 into Bank United as common equity capital had two distinct effects." Appellants explain that the infusion of these funds both "added back some of the leverage capacity lost due to the breach" and "added $35,338,988 in cash to Bank United that otherwise would have had to be borrowed." Appellants continue by stating that "[t]his [second] effect, the savings in day-to-day funding costs that would otherwise have been incurred, is separate from the restoration of leverage capacity and goes beyond mitigation of the harm caused by the breach."

Appellants' characterization of the effect of the $35 million infusions as merely "the savings in day-to-day funding costs" points out the flaw in their argument. The effect of the capital infusions was not merely a savings in borrowing costs. Rather, if the capital infusions replaced funds that would otherwise have been borrowed, they prevented Bank United from incurring a $35 million debt that it eventually would have been required to repay. Thus, the capital infusions not only relieved Bank United of the need to make interest payments on the $35 million that it otherwise would have borrowed, they also relieved Bank United of having to repay principal in the amount of $35 million.

By assuming that the capital infusions merely resulted in a reduction in borrowing costs, Appellants completely fail to take into account the effect on Bank United of having avoided a $35 million liability. Whether the $35 million is assumed to have been invested or used to have replaced funds that otherwise would have been borrowed, the result is the same: Bank United was worth an additional $35 million as a result of the net increase of its assets in that amount. Accordingly, as the trial court found, in addition to mitigating the lost leverage capacity resulting from the govern-

ment's breach, the infusion added $35 million in "investable assets" to Bank United. And, as Bank United's owner, Hyperion necessarily captured that increase either through the increased value of Bank United or as dividend payments.

Appellants' further argument that this court's precedents compel a contrary conclusion is similarly flawed. Appellants contend that, as in *Bluebonnet Sav. Bank, FSB v. United States,* 266 F.3d 1348, 1355-56 (Fed. Cir. 2001), this $35 million capital infusion constitutes a "financing cost" that should be recoverable in whole. Similarly, they contend that, as in *Hughes Communications Galaxy, Inc. v. United States,* 271 F.3d 1060, 1066-69 (Fed. Cir. 2001), the $35 million should be considered to be part of the additional cost of obtaining a substitute performance or "cover." At bottom, these cases stand for the well-established principal that a non-breaching party may recover the actual costs of mitigating a breach. As explained above, the trial court found that the $35 million infused into Bank United was never expended or "lost" and therefore was not a "cost" of mitigation.

In sum, Appellants' argument fails to demonstrate any error, much less clear error, in the trial court's finding that they are not entitled to recover the $35 million because this amount represents an investment that they "still have or have transferred." Accordingly, we must decline to hold that the trial court erred in refusing to award this amount as mitigation damages.

B.

In their post-trial motions, Hyperion and Bank United claimed that they were entitled to $57,074,034 in mitigation damages representing a 20 percent rate of return on the $35,338,988 that was infused. The trial court rejected Appellants' claim, finding that: "[t]o award a hypothetical rate of return on [the $35 million] would be a duplication of whatever return the infusing Plaintiffs have already received from their investment."

On appeal, Hyperion and Bank United renew the argument they made to the trial court. Thus, Appellants contend

that "[i]f the Government had not breached, Plaintiff-owners would have retained the $35,338,988 for use in other investments and also received the returns actually produced by Bank United without the need to add more regulatory capital." According to Appellants, any "return" earned as a result of the $35 million that was infused into Bank United represents the mitigating effect of that infusion. Therefore, they contend that the trial court erred in concluding that rewarding them lost returns on the infused funds would be a "duplication" of returns they already received on their investment.

Appellants' argument again ignores the distinction drawn by the trial court between the restoration of borrowing capacity and the addition of "investable assets" to Bank United. As discussed above, the trial court found that "[t]he new capital, insofar as mitigation is concerned, was replacing borrowing capacity, not tangible assets." Thus, the capital infusions "not only restored borrowing capacity, but provided that much cash for the bank's growth." Accordingly, in addition to the mitigating effect of restoring borrowing capacity, the infusions provided Bank United with an additional $35 million that itself could be invested and on which Bank United earned a return. Bank United and Hyperion fail to demonstrate any difference between the rate of return earned on the $35 million that was infused and the rate of return that otherwise would have been earned on alternative investments. Thus, we have no basis for concluding that Appellants suffered any damages by investing the $35 million in Bank United instead of an alternative investment.

In short, Appellants' argument fails to demonstrate any error in the trial court's rationale for refusing to award them supposedly-lost returns on the $35 million that was infused into Bank United. Accordingly, we conclude that the trial court did not clearly err in denying Appellants' claim for $57,074,034 in lost returns.

C.

Hyperion and Bank United next contend that the trial court erred in declining to award them $54,126,972 in divi-

dend payments made on the preferred stock issued by Bank United in 1992.

In denying Appellants' post-trial motions, the trial court stated that "[t]he essence of my disagreement with Plaintiffs' position is that the reimbursements they now seek are not for the transaction costs of mitigating . . . but for the money raised to pursue aims which would have required infusions or acquisitions of real cash to accomplish, even in the absence of the FIRREA breach."

On appeal, Hyperion and Bank United argue that "the leverage capacity restored by the preferred stock's addition of $85,500,000 in regulatory capital to Bank United would, absent the breach, have been available without the need to pay preferred stock dividends." Therefore, they contend, the trial court erred in refusing to award them the dividend payments as mitigation costs.

As with the arguments addressed above, Appellants fail to demonstrate any clear error in the trial court's findings. The trial court limited its initial award of damages to the transaction costs incurred by Appellants in the 1992 preferred stock issuance. *Bank United II,* 50 Fed. Cl. at 665. Again in its ruling on the post-trial motions, the trial court explained that the "essence of [its] disagreement with [Appellants'] position" was that they sought an award that went beyond transaction costs. The trial court's finding that Appellants' mitigation costs associated with the 1992 preferred stock offering were restricted to transaction costs is consistent with testimony offered by the government's lead expert at trial that, because the value of the cash proceeds of a capital offering equal the expected expense of future dividends, the true costs of such a transaction are limited to floatation costs. We have previously declined to hold such a finding clearly erroneous, and we do so again here. *See Cal. Fed. Bank, FSB v. United States,* 245 F.3d 1342, 1350 (Fed. Cir. 2001).

V. CROSS-APPEAL ON DAMAGES

The issue remaining for us to address is raised by the government's cross-appeal of the trial court's award of

$3,942,500 representing the transaction costs associated with Bank United's $85.5 million preferred stock issuance. In its damages decision, the trial court found that Bank United's issuance of 3,420,000 shares of noncumulative, preferred stock, which occurred on December 29, 1992, was a mitigating transaction. *Bank United II,* 50 Fed. Cl. at 665. Accordingly, the court found that Appellants were entitled to recover $2,992,500 in commissions and $950,000 is other expenses associated with the stock offering. *Id.*

On appeal, the government contends that the trial court committed clear error in finding that the 1992 stock issuance was a reasonable mitigating transaction. This is so, accordingly to the government, because "any 'adverse effect' of the breach upon Bank United's leverage capacity ended on December 31, 1992, and, thus, any benefit derived from any ability to operate at a capital level lower than otherwise required disappeared." Moreover, emphasizes the government, "any adverse effect during 1992 was insignificant and immaterial, because (as of the beginning of that year) the capital level required by the capital forbearance and the prevailing capital requirements converged at three percent, though there were minor computational differences" (citation and emphasis omitted). Therefore, the government argues, the "transaction costs related to raising $85.5 million in equity bore no relationship to the costs necessary to replace [the] insignificant and immaterial amount of lost leverage capacity" remaining on December 29, 1992, two days before the end of the damages window.

Appellants reply to the government's argument by pointing out that "[t]he trial court did not rule that the preferred stock mitigated 'two days' of lost leverage capacity" but rather "focused on mitigation that, in [its] view, enabled [Appellants] to pursue their long-term strategy and plans for Bank United." Appellants further claim that the timing of the stock offering does not preclude its being a mitigating transaction, arguing that "[b]y its nature, the loss of leverage capacity caused by the breach had continuing, long-term effects

on Bank United that did not disappear on December 31, 1992."

We cannot accept Appellants' mere assertion that the government's breach had "continuing, long-term effects" which were mitigated by the 1992 stock offering. Appellants have entirely failed to direct our attention to any evidence in the record demonstrating any effects of the breach extending beyond the damages window. Nor is it apparent from the trial court's extensive decision what such continuing effects might be. Accordingly, we reverse the trial court's award of $3,942,500 representing the transaction costs associated with Bank United's 1992 preferred stock issuance.

CONCLUSION

For the foregoing reasons, we affirm the trial court's grant of summary judgment as to liability and its denial of the additional damages sought by Appellants. However, we reverse the trial court's award of $3,942,500 in mitigation damages associated with the 1992 preferred stock issuance.

No costs.

APPENDIX B

United States Court of Federal Claims
October 29, 2001

No. 95-473 C

BANK UNITED OF TEXAS, FSB, USAT HOLDINGS INC., HYPERION HOLDINGS INC. and HYPERION PARTNERS L.P.,	)	*Winstar*-related case; FIRREA; breach of contracts; damages; mitigation
Plaintiffs,	)	
versus	)	
UNITED STATES OF AMERICA,	)	
Defendant.	)	

Walter B. Stuart, IV, Houston, TX, for plaintiffs. David T. Hedges, Jr., John D. Taurman, Karen Jewell, James A. Reeder, Jr., Tegan Flynn, Joseph E. Hunsader, Fred Williams and Michael Holmes, of counsel.

John J. Hoffman, with whom were Acting Assistant Attorney General David W. Ogden, David M. Cohen and Jeanne E. Davidson, Washington, DC, for defendant. Colleen Conry, Teresa Kolb, Luke Levasseur, Jerome A. Madden and Marc Sacks, of counsel.

OPINION and ORDER

TURNER, Judge.

This suit arises from the impact of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73 (Aug. 9, 1989), on the savings and loan industry. Following the Supreme Court's decision in *United States v. Winstar Corp.*, 518 U.S. 839 (1996), holding that FIRREA breached the government's contracts with three thrift institutions, this court—finding breach of a similar contract—granted summary judgment for plaintiffs on the issue of liability. *Bank United of Texas v. United States*, 49 Fed. Cl. 1 (1999) (Smith, C.J.). The case was then transferred to this judge for resolution of damages. A damages trial was held over a six-week period in September and October 1999, and final arguments were heard on February 7, 2000.

The sole basis for damages sought by plaintiffs is alleged lost profits, although plaintiffs presented evidence concerning the cost of substitute capital in the event the court determined that law requiring mitigation of damages precluded recovery of lost profits.

We conclude that plaintiffs are not entitled to lost-profit damages resulting from the contract breach but that they are entitled to damages of $8,826,783 for the proven costs incurred to mitigate the breach.

I

During the 1980's, there was widespread financial deterioration of the thrift industry leading to the insolvency of the Federal Savings and Loan Insurance Corporation (FSLIC) fund insuring deposits held by thrift institutions. In 1987, the thrift industry reported a net loss from operations of over $8 billion, and the reserves in the insurance fund had decreased to a negative $13.7 billion. Pl. Mem. (7/15/99) at 5. By the end of 1987, over 500 savings institutions were insolvent, including 117 in Texas. Pl. Br. (12/15/99) at 8; PX 460 at 24; PX 391 at BU942215. In 1988, the FSLIC insurance

fund had a loss of $66 billion, bringing its total deficit to $75 billion. Pl. Br. (12/15/99) at 8.

The FSLIC lacked the funds necessary to liquidate the insolvent thrifts. As an alternative, the FSLIC sought to merge failing thrifts with healthy thrifts or to attract private investors to purchase failed thrifts in exchange for regulatory forbearances.

In February 1988, the Federal Home Loan Bank Board (FHLBB) and FSLIC promulgated the Southwest Plan to deal with problems faced by thrifts in the Southwest, especially in Texas. Pl. Mem. (7/15/99) at 5. In its 1988 Annual Report, the FHLBB wrote:

> The Board, well aware that thrift problems were concentrated in Texas, developed the Southwest Plan to deal with the situation while also proceeding to resolve the worst cases elsewhere. The Southwest Plan, formally introduced in February 1988, combined consolidation of an overbuilt thrift industry with attracting acquirers who would bring in strong management, new capital, and carry out a business plan aimed at cutting operating costs and ultimately reducing the high interest rates being paid on deposits.

Pl. Br. (12/15/99) at 8; PX 460 at 2.

To attract outside investors, FSLIC made regulatory commitments to potential acquirers. Many of the deals had common features including (1) FSLIC providing cash or a promissory note in an amount equal to the difference between the book value of the institution's assets and its liabilities; (2) FSLIC agreeing to provide capital-loss coverage and yield maintenance payments for non-performing assets the acquirer agreed to liquidate on FSLIC's behalf, and (3) FSLIC agreeing to forbear from enforcing certain regulations against the acquirer or to otherwise liberalize the application of regulations. PX 391 at BU942216-17.

Such assisted transactions had advantages to the FDIC when compared with liquidation such as (1) maintaining

goodwill, (2) requiring payment only for an insolvent thrift's deficit rather than the full amount of insured deposits, and (3) reducing immediate cash payment by substituting a variety of other benefits including notes, capital-loss coverage, tax benefits, regulatory forbearances and interstate branching rights. These arrangements allowed FSLIC to resolve a greater number of thrifts with its limited resources than it could have through liquidation. Pl. Br. 12/15/99 at 9-10.

An assisted transaction having a number of features attractive to plaintiffs and to thrift regulators was negotiated and completed in late 1988.

II

A brief history of the plaintiffs and a description of the agreement between plaintiff Hyperion Partners L.P.[1] and the government will assist in understanding the damages resolution. Plaintiffs are Hyperion Partners L.P., Hyperion Holdings Inc., USAT Holdings Inc. and Bank United of Texas FSB.

A

In 88, Lewis Ranieri resigned his position as Vice Chairman at Salomon Brothers and with his associates Scott Shay[2] and Salvatore Ranieri[3] formed Hyperion Partners L.P.

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[1] Hyperion Partners L.P. included a general partner, Hyperion Ventures L.P., organized by Lewis Ranieri, Salvatore Ranieri (Lewis' brother) and Scott Shay. The limited partners included various institutional and individual investors. The general partner contributed $4.3 million and the limited partners pledged total contributions of $430 million to the partnership. JX 20 at BU603431-32.

[2] Scott Shay was formerly in charge of Salomon Brothers' savings and loan merger-acquisition practice, as well as its mortgage banking corporate finance practice. Tr. 211-12 (L. Ranieri); Tr. 662 (Shay).

to make investments in the financial services, real estate and housing markets. Def. Br. (12/15/99) at 4; Def. Mem. (7/28/99) at 5; Pl. Br. (12/15/99) at 4, 10. The partnership was initially capitalized with $4.3 million from the general partner, Hyperion Ventures L.P., and obtained pledges for up to $430 million from the limited partners. JX 20 at BU603431-32.

Prior to his involvement with Bank United, L. Ranieri had assisted the government in resolving problems with other thrifts. Tr. 235-39 (L. Ranieri). Between 1987 and 1990, L. Ranieri acted as an informal advisor to regulators of the thrift industry. Tr. 239 (L. Ranieri).

L. Ranieri first became aware of the Southwest Plan in late 1987 or early 1988 when Danny Wall, Chairman of the FHLBB, made a presentation about the plan at an industry conference. Tr. 239-41 (L. Ranieri). Initially, L. Ranieri was not interested in participating because Hyperion Partners L.P. preferred to invest in healthy thrifts. Tr. 243 (L. Ranieri); Tr. 691-92 (Shay). Over the summer of 1988, however, Hyperion Partners L.P. began to consider investing in insolvent thrifts. Tr. 692-93 (Shay).

B

In the fall of 1988, Hyperion Partners L.P. bid on a number of savings and loan packages offered by the FSLIC and the FHLBB. Def. Mem. (7/28/99) at 6. Eventually, Hyperion Partners L.P. entered into negotiations to purchase a failed thrift named United Savings Association of Texas (Old United). *Id.*

[Footnote continued from previous page]

[3] Salvatore Ranieri is a lawyer and investor and is the brother of Lewis Ranieri. Tr. 212 (L. Ranieri).

The parties wanted to complete the transaction by the end of 1988. There was a flurry of negotiations and document exchanges between Hyperion Partners L.P. and the regulators in December 1988.

On December 13, 1988, Hyperion Partners L.P. submitted a draft regulatory forbearance letter to the FHLBB. PX 369. On December 16, 1988, Linda Plye, Director of the FHLBB Office of Regulatory Activities (ORA), informed Hyperion Partners L.P. that it needed to submit (1) an acceptable business plan (pro forma financial statements and a detailed narrative) and (2) a complete, acceptable statement of need for each of the forbearances requested in connection with the proposed transaction (Justification Letter). Tr. 4097-98 (Plye); DX 824 at BU610152-53.

On December 20, 1988, Hyperion Partners L.P. submitted its holding company application (HCA) for the acquisition of Old United, together with its business plan narrative and financial projections (pro formas) detailing the intended operating strategy for the thrift. DX 794A. Hyperion Partners L.P. submitted its second letter requesting forbearances also on December 20, 1988. DX 828. On December 21, 1988, Hyperion Partners L.P. submitted its justification for the forbearances.

Hyperion Partners L.P. had created the holding company Hyperion Holdings Inc., wholly owned by Hyperion Partners L.P., to facilitate the acquisition of Old United. Hyperion Holdings Inc. owned all of the stock of another holding company, USAT Holdings Inc., which acquired the assets and assumed the liabilities of Old United on December 30, 1988. On that date, a new thrift institution, United Savings Association of Texas, FSB (USAT), was created to receive the assets and liabilities of Old United and to operate as a solvent bank. (USAT's name was changed to Bank United of Texas FSB in 1992, after a 1991 merger with a related institution created to facilitate acquisition of other thrifts). DX 1017, ¶ 7; Pl. Br. (12/15/99) at 13 n.2. For convenience, the terms USAT and Bank United are hereafter used interchangeably to designate the plaintiff bank.

C

The negotiations and document exchanges resulted in numerous agreements including (1) an acquisition agreement between FSLIC and Bank United, JX 9; (2) an assistance agreement between FSLIC and all plaintiffs, JX 10; (3) a warrant agreement between FSLIC and Bank United, JX 12; (4) a regulatory, capital-maintenance agreement between FSLIC and all plaintiffs, JX 13, and (5) an agreement for operating policies between FSLIC and Bank United, JX 14. Pl. Br. (12/15/99) at 13. In addition, the FHLBB approved the acquisition pursuant to a set of resolutions, JX 15, which included a forbearance letter to Hyperion Partners L.P. finalized on February 15, 1989, JX 11.

As part of the December 1988 transaction, plaintiffs agreed to capitalize the new bank by infusing $200 million, including $90 million as traditional equity[4] and $110 million as subordinated debt.

Under the assistance agreement, FSLIC eliminated the "book value" and "market value" insolvency of Old United.

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[4] Sixty million dollars came from a Hyperion Partners L.P. capital call sent down through Hyperion Holdings Inc. to USAT Holdings Inc. and then into Bank United as equity. DX 1017. Thirty million dollars came from a loan from Westinghouse Credit which was sent down through a series of loans to Hyperion Holdings Inc. and USAT Holdings Inc. which then infused the $30 million as equity into Bank United. DX 1017. (The Westinghouse Credit loan was repaid with a loan from the Bank of New York (BONY) on December 21, 1989. The BONY loan was repaid from proceeds of a sale of common stock of USAT Holdings Inc. to Prudential Insurance, Ameritech Pension and affiliates of Equitable Life.) Thus, after Bank United was initially capitalized, $370 million remained of the $430 million committed by the limited partners when Hyperion Partners L.P. was formed. DX 883. The $110 million raised by the bank as subordinated debt was not part of the capital commitment. DX 883.

JX 10; Tr. 2487-92 (Viitala). FSLIC also provided "coverage" on approximately 70 percent of the $5 billion of assets acquired from Old United. This coverage was provided in two ways. First, FSLIC guaranteed that Bank United would recover a guaranteed yield on specific covered assets for a certain time. Tr. 2494-95, 2497-98 (Viitala); DX 1198; JX 10. Second, FSLIC protected Bank United from any capital losses on the sale or regulator-directed write down of the covered assets. Tr. 2492-94 (Viitala); JX 10.

Under the forbearance arrangement, the government agreed that it would not enforce its minimum capital-ratio regulations against Bank United for ten years so long as Bank United was in compliance with a "Capital Plan," JX 11 at 1-2; Pl. Br. (12/15/99) at 14 n. 4, which had the following relevant provisions: Bank United's minimum capital-ratio requirement was to be 1.5 percent until the $110 million of subordinated debt was issued. After placement of the subordinated debt, the minimum capital-ratio requirement would increase to 2.0 percent. The required capital ratio would then "stair step" up by 0.5 percent at the end of each of the years two through ten until it reached the level required under then-current regulations. Pl. Br. (12/15/99) at 15; JX 11 at 2; PX 588; PX 600.

The FHLBB's forbearance letter explicitly provided that the proceeds of the subordinated debt would be treated as equity in computing the bank's capital ratio (i.e., although the bank would incur real debt to obtain the $110 million, for the purpose of calculating the required capital ratio, such obligation would not be counted as a liability). JX 11, ¶ 1. The FHLBB resolution approving the merger also stated that the subordinated debt would be included in regulatory capital under then-existing regulations or successor regulations. JX 15 at 39-40; PX 600.

Finally, the forbearance letter provided that the supervisory goodwill created by the transaction would count as regulatory capital to be amortized over 25 years. Tr. 262-63 (L. Ranieri); JX 11, ¶ 7(a). FSLIC agreed to pay Bank United the difference between the market value and the higher book

value of certain assets which was calculated to be over $170 million and was to be paid to Bank United over several years. Pl. Br. (12/15/99) at 15. In order for the value of that FDIC commitment to be properly reflected on Bank United's books, the commitment had to be discounted to present value. *Id.* The difference between the discounted present value of payments from FSLIC and the face amount of the receivable constituted supervisory goodwill. *Id.* at 16. It was agreed that $34.9 million (later restated to $30 million), or the unamortized balance at a given time, would be counted as supervisory goodwill (i.e., as an asset with no off-setting liability) in the computation of the regulatory capital ratio. *Id.* at 16.

On December 30, 1988, the acquisition of Old United, newly chartered as United Savings Association of Texas, FSB, was completed. Pl. Br. (12/15/99) at 12.

D

In summary of its principal, relevant terms, the transaction among FSLIC, FHLBB and plaintiffs provided (1) that plaintiffs would accomplish infusion of $200 million into the new bank ($90 million as equity and $110 million as subordinated debt), (2) that the subordinated debt could be counted as equity for the purpose of calculating the required capital ratio, (3) that $34 million of goodwill created by the transaction—later adjusted by agreement to $30 million—would count as capital (i.e., an asset without an off-setting liability) to be amortized over 25 years, and (4) that government regulators would forbear enforcement of regulatory capital-ratio[5]

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[5] The minimum capital ratio required under FIRREA was 3.0 percent derived from dividing core capital (net worth) by adjusted total assets. FIRREA called this ratio a "leverage ratio." *See* 12 C.F.R. § 567.8. In this opinion, "capital ratio," "minimum capital ratio" and "regulatory capital ratio" are used interchangeably.

[Footnote continued on next page]

requirements for ten years so long as the bank maintained an agreed, lesser capital ratio.

E

FSLIC estimated that it would have cost the government $2.2 billion to $2.5 billion to liquidate Old United. JX 29. The cost of the financial assistance in selling to Hyperion Partners L.P. was estimated to be $1.8 to $2.0 billion.[6] JX 29; Tr. 702-06 (Shay).

F

Promptly after the terms of the transaction were agreed upon and approved, plaintiffs accomplished the stipulated infusion of $200 million into the new bank, consisting of $90 million of equity capital and $110 million of subordinated-debt proceeds.

Early in 1989, shortly after conclusion of the transaction, legislation was proposed in Congress which, if enacted, would undermine the agreement. This legislation ultimately became FIRREA and, as indicated above, breached several provisions of the contract between plaintiffs and the govern-

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[Footnote continued from previous page]

Prior to FIRREA, the required capital ratio for thrifts was derived from dividing net worth by total liabilities (but some subordinated debt was permitted to be counted as capital rather than as a liability for this purpose). Dividing net worth by total liabilities results in a slightly higher capital ratio than dividing net worth by total assets and thus would provide slightly more leverage capacity. Such change in the method for computing capital ratio has not been treated as material in this litigation.

6 This does not include tax benefits in the form of net operating loss carry-forwards (NOLs) that Bank United was permitted to assume from Old United, which had totalled $125 million in tax savings as of the time of trial. Def. Br. (12/15/99) at 9.

ment having an impact on calculation of required minimum capital ratios.

III

FIRREA became law on August 9, 1989. PX 383; PX 648, tab 7. Passage of FIRREA was followed by implementing regulations establishing new minimum-capital ratios published by the Office of Thrift Supervision (OTS) on November 8, 1989, effective on December 7, 1989. 54 Fed. Reg. 46845 (Nov. 8, 1989). On January 9, 1990, the OTS issued Thrift Bulletin 38-2 which eliminated previously-granted capital-ratio and accounting forbearances. OTS, Thrift Bulletin 38-2 (Jan. 9, 1990).

FIRREA and its implementing regulations constituted an egregious breach of the three significant, bargained-for provisions of the contract between plaintiffs and government regulators which directly impacted calculation of capital ratio and, hence, leverage capacity, i.e., the provisions concerning forbearance of capital-ratio enforcement, counting subordinated debt as equity and long-term amortization of supervisory goodwill.

A

One adverse impact of FIRREA on Bank United was to rescind the Capital Plan and establish a minimum required capital ratio of 3.0 percent of assets. Pl. Br. (12/15/99) at 23; Tr. 744 (Shay). Under the Capital Plan, Bank United's capital-ratio requirement had been 2.0 percent of liabilities (it was raised from 1.5 percent to 2.0 percent when the subordinated debt was placed prior to FIRREA) or 1.8 percent of assets.

Another adverse effect of FIRREA was that subordinated debt could no longer be counted as regulatory capital. This change reduced Bank United's capital ratio from 6.23 percent on June 30, 1989 to 3.12 percent on September 30, 1989 (a level dangerously low for an operating bank, though not out of capital compliance, and less than required for a

prudent capital cushion). Pl. Br. (12/15/99) at 23; PX 592; Tr. 747-49 (Shay); PX 302 at 4.

Finally, FIRREA required that supervisory goodwill be amortized over 5 years rather than 25 years. 103 Stat. 183 (1989); PX 383. This had the effect, beginning in 1990, of requiring Bank United to reduce the $30 million of goodwill on its books (which, for the purpose of calculating capital ratio, could be counted as an asset without offsetting liability) at the rate of $6 million per year rather than $1.2 million per year, all in violation of the 1988 contract. *See* JX 11.

B

Plaintiffs treat the impact which prohibited counting the subordinated debt as capital as effective by September 30, 1989. For other purposes, the parties treat the period of primary impact of FIRREA—the "damages window"—as beginning on December 31, 1989 and ending on December 31, 1992 (when the required capital ratio under FIRREA equaled the minimum permitted under the capital forbearance agreement and by which time Bank United had raised $85.5 million through issuance of preferred stock). Given the resolution of damages issues (i.e., that mitigation principles preclude lost-profits damages), the precise effective date for each impact of FIRREA is not critical.

C

The damages window, agreed upon by the parties, was the three-year period between the end of 1989 and the end of 1992. In January 1992, the capital ratios, which stair-stepped up under the forbearance agreement, nominally converged with FIRREA's requirements. However, since the pre-FIRREA ratio was a percentage of qualifying liabilities and the post-FIRREA ratio was a percentage of qualifying assets, the damages window was extended to the end of 1992 to take into account the potential loss of leverage through 1992.

The significance of this damages window is that it was the period during which the contract breach resulting from FIRREA adversely impacted Bank United's calculation of

capital ratios. Thus, the damages issue becomes the extent to which plaintiffs were adversely affected by loss of leverage capacity during the damages window.

D

In addition to changes which directly impacted Bank United's calculation of capital-ratio, FIRREA changed the identity of thrift regulatory agencies. The independent FHLBB was eliminated and replaced with the Office of Thrift Supervision (OTS), an agency within the Treasury Department. PX 460 at 12. Also, FIRREA dissolved FSLIC, established a new thrift deposit insurance fund under the Federal Deposit Insurance Corporation (FDIC) and created the Resolution Trust Corporation (RTC) charged with liquidating or disposing of closed thrifts. PX 460 at 23.

FIRREA directed the RTC to review and analyze all insolvent institution cases resolved between January 1, 1988 and the date of enactment of FIRREA, and to exercise any and all legal rights to modify, renegotiate or restructure those agreements. PX 383 at 190 (FIRREA § 501). Bank United's agreement with defendant was reviewed by the RTC in 1990. PX 387 at BU942068; PX 389 at BU943202-03; Tr. 1602-04 (Wood); Tr. 1880-84 (S. Ranieri). While this review undoubtedly placed a cloud of uncertainty over Bank United's planning until it was completed, no specific damages impact resulting from such review is asserted by plaintiffs.

IV

Much of the trial was devoted to presentations by plaintiffs, with ultra-detailed explanations, of voluminous "models" purporting to demonstrate lost profits. Much of defendant's case-in-chief was devoted to demonstrating inappropriate assumptions and flaws in plaintiffs' models. Four highly-credentialed experts gave extensive testimony in support of or undermining plaintiffs' lost profits models. Other witnesses testified on discrete aspects of relevant background (e.g., existence and magnitude of the securitized-loan market, prudent capital cushions, impacts of taxation) intended to support or discredit assumptions in the models.

A

Plaintiffs submitted two alternative models at trial intended to demonstrate with reasonable certainty that Bank United suffered lost profits. The first model (the "three-breach" model) purports to measure profits lost as result of the three specific adverse impacts of FIRREA and concludes that the impacts caused $558 million in lost profits. The second model (the "one-breach" model) purports to measure profits lost solely as a result of plaintiffs' post-FIRREA inability to count subordinated debt as regulatory capital (rather than as a liability); plaintiffs assert $96 million in lost profits from this single impact of FIRREA. (A third model, discussed below, was furnished by plaintiffs to demonstrate the full cost of substitute capital, i.e., mitigation costs, in the event of a ruling that lost profits are not awardable.)

B

The "three-breach" model compares Bank United's actual profits over a ten-year period with the profits it allegedly would have made if FIRREA had not been enacted. Plaintiffs claim that the "three-breach" model is conservative, match-funded and based on the activities of the actual bank.

In order to create the "three-breach" model, plaintiffs' damages expert collected all of Bank United's quarterly thrift financial reports (TFR), which included complete balance sheets, income statements and supporting documentation, as well as additional financial data. Tr. 2682-83 (Myers); Pl. Br. (12/15/99) at 40. The "three-breach" model posits a "but for" bank hypothetically operating as if the breach impacts had not occurred. The "three-breach" model supposes the same management team, a capital ratio cushion similar to that of the actual bank and discounts for the use of net operating losses (NOLs). The "three-breach" model also hypothesizes that the "but for" bank had unlimited access to worthy wholesale investments during the damages window. From this data, and from conversations with Bank United's investors and managers, plaintiffs' damages expert concluded that Bank United would have operated on a larger scale absent the

breaches. Tr. 2633-34, 2666-69 (Myers); PX 653; PX 664; Pl. Br. (12/15/99) at 41. In addition, the model projects that the "but for" bank would have expanded primarily through wholesale growth. Tr. 2671, 2688-92.

The added regulatory capital and resulting leveraging capacity afforded by the forbearances (eliminated by FIRREA) are used to augment a "wholesale strategy." ("Wholesale" means the purchase of mortgage-loan packages ("whole loans") and mortgage-backed securities (MBS), in contrast to mortgage-loan assets originated by Bank United's making direct loans.) The funding of such wholesale purchases in the "three-breach" model is accomplished through advances from the FHLB and by reverse repurchase agreements and not by additional retail deposits.[7] According to plaintiffs, the "three-breach" model adds the additional wholesale assets that Bank United would have acquired with the forbearances in place in the same proportion that Bank United was actually purchasing at the time.

The assumed profits generated from these additional purchases are calculated using actual historical yields on Bank United's contemporaneous wholesale purchases, reduced by 0.15 percent as to whole loans. The added operating costs and other charges such as taxes incurred in conducting the additional wholesale activity are then deducted from the spread between the yields and funding costs associated with the additional purchases. Lost profits are calculated by taking the difference between Bank United's actual earnings and

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[7] A reverse repurchase agreement is one by which a bank uses its high quality liquid assets as collateral and borrows against them a percentage of their face value. Tr. 1208 (Nocella).

The spread that can be earned between FHLB advances and reverse repurchases, on the one hand, and wholesale assets, on the other, is smaller than if the funding were done with retail deposits. Plaintiffs argue that this reflects the overall conservative nature of the model. Pl. Mem. (7/15/99) at 20.

its estimated earnings if the breach and its resulting impacts had not occurred. Tr. 2669-70, 2753-54 (Myers); PX 665; PX 666; PX 687. According to plaintiffs, Bank United would have increased its net holdings of MBS and whole-loan packages by approximately $4 billion by late 1992 and $11 billion by early 1997. Tr. 1233 (Nocella); PX 323; PX 302 at 87-91; Pl. Br. (12/15/99) at 43 n.23. During the damages window, Bank United would have a net incremental balance of MBS in the amount of approximately $1 billion and a net incremental balance of residential mortgages (whole loan packages) of approximately $3 billion. Pl. Mem. (7/15/99) at 33.

In support of the "three-breach" model and its conclusions, plaintiffs presented convincing testimony that (1) plaintiffs were experts in the wholesale mortgage markets; (2) wholesale activities were a natural way to take advantage of the three-year window of opportunity provided by the Capital Plan; (3) even with the breach, Bank United's wholesale activities were "extensive," and (4) the wholesale markets were "gigantic." Pl. Br. (12/15/99) at 42-43.

Plaintiffs clearly had significant expertise in the wholesale mortgage markets. L. Ranieri helped to create the secondary mortgage market while at Salomon Brothers. Tr. 181-203 (L. Ranieri). Shay and Anthony Nocella[8] also had years of experience in these markets. Tr. 662-665 (Shay); Tr. 1181-84 (Nocella). Bank United had the necessary infrastructure in place to pursue wholesale acquisitions by the

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[8] At the time of trial, Nocella was Vice Chairman, chief financial officer and a member of the board of directors of Bank United. Tr. 1179 (Nocella). Prior to joining Bank United, Nocella had been employed at Philadelphia Savings Bank where he ran the wholesale operation and was chief financial officer. *Id.* at 1181. In 1987, he formed Nocella Management Company, an asset-liability management consulting firm. *Id.* He joined Bank United in 1990. *Id.*

summer of 1989. Tr. 1195-97 (Nocella); Tr. 2690 (Myers). There was testimony by witnesses for both parties that expanding wholesale activities would have been a natural way to take advantage of the three-year window of opportunity provided by the Capital Plan. Tr. 2689, 2756-58 (Myers); Tr. 2191-92 (Ford); Tr. 4773-74 (Bankhead).

Plaintiffs demonstrate that Bank United's actual whole loan purchases exceeded $11 billion and MBS purchases were in the billions over the ten-year period covered by the model. PX 605; PX 606. Further, plaintiffs show that the bank's volume wholesale assets as a percentage of total assets grew rapidly during the 1990s reaching 50 percent of total assets by the mid 1990s. Tr. 2678-79 (Myers); PX 323; PX 302 at 87-91; PX 669; PX 307.[9] (However, these facts are not inconsistent with the proposition that initially Bank United focused on retail growth supplemented by wholesale purchases and turned to a wholesale-growth strategy only after disintermediation significantly slowed acquisition and retention of retail deposits.)

In addition to the wholesale assets purchased by the actual bank, the "but for" bank purchased $1 billion in additional wholesale assets per year. PX 609; PX 302 at 14-17. Plaintiffs showed that the market for one-to-four family mortgages outstanding increased from $2.4 trillion in 1989 to

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[9] Bank United's actual MBS purchases during its first ten years of operation were as follows: $155.2 million in 1989; $46.4 million in 1990; $190 million in 1991; $147.9 million in 1992; $778.2 million in 1993; $497.1 million in 1994; $39.5 million in 1995; $299.8 million in 1997, and $356.8 million in 1998. PX 302 at 87-88; PX 606. Bank United's whole loan purchases during its first ten years of operation were as follows: $499.2 million in 1990; $1.9 billion in 1991; $1.2 billion in 1992; $763.7 million in 1993; $1.29 billion in 1994; $2.7 billion in 1995; $377.9 million in 1996; $418.5 million in 1997, and $1.7 billion in 1998. PX 302 at 89-91; PX 605.

$4.3 trillion in 1998 with upwards of $800 billion available for sale annually. Tr. 2198, 2203-04 (Ford); PX 607. Plaintiffs thus conclude that their assumed additional $1 billion in annual purchases would have been minuscule in light of the depth of the market. PX 609; PX 302 at 14-17; Tr. 2250-51, 2196-98 (Ford). The MBS market was also large, increasing to $2.274 trillion in 1998. PX 608. One of defendant's experts confirmed that these securitized-loan markets were "gigantic." Tr. 3515-16 (Fischel).

C

Plaintiffs alternative "one-breach" model purports to demonstrate that Bank United suffered $96.085 million of lost profits solely from the subordinated-debt impact of the breach. Tr. 2908; PX 717.

As a result of the breach impact on subordinated debt, Bank United's capital ratio dropped from 6.0 percent to barely above 3.0 percent, resulting in lost leverage capacity exceeding $3.6 billion.[10] JX 253 at BU901184; JX 254 at BU896686; Pl. Br. (12/15/99) at 88-89. Plaintiffs argue that if Bank United had been able to count the subordinated debt as regulatory core capital, it would have been a bigger and more profitable thrift. Tr. 2899 (Myers).

The "one-breach" model attempts to show that if Bank United had been able to count $110 million in subordinated debt as regulatory capital, the resulting increase in leverage capacity would have permitted it to invest in an additional $3.5 billion of assets even with the higher capital ratio required by FIRREA. This model estimates that the additional wholesale assets which would have been purchased during the nine-month period between breach and mitigation by re-

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[10] Leverage capacity provided by the subordinated-debt forbearance alone was $5.5 billion based on the 2.0 percent minimum capital ratio permitted by the Capital Plan. Pl. Br. (12/15/99) at 89 n.53. This capacity was obliterated by FIRREA.

placement of the subordinated debt with an equity infusion would have garnered the same rate of return on capital which the actual bank earned.

Plaintiffs assert that while the exchange of the subordinated debt for equity permitted the $110 million to qualify as regulatory capital, it did not end lost-profit damages. In order to capture alleged continuing damages, the "one-breach" model applies the actual bank's rate of return on capital in subsequent years to the additional capital Bank United would have had absent the breach and counts the resulting lost revenue as recoverable lost profits. Tr. 2906-07 (Myers); PX 716; PX 302 Table 4-1 at BU950689.

D

In broad summary of both lost-profits models, plaintiffs posit that Bank United, from its inception, would have used all prudently available leverage capacity to pursue a massive wholesale strategy, investing primarily in wholesale assets, that its matched-funding techniques would never fail to produce a positive rate spread and that it would at all times find wholesale assets (whole-loan packages or MBS's) which met the investment criteria of its unquestionably astute, experienced management.

V

Defendant elected to counter plaintiffs' case on all fronts, both attacking on the merits their claim of entitlement to lost profits and asserting that any such claim is barred by the doctrine of mitigation of damages.

With respect to the lost-profits models, defendant presented evidence in support of its assertion that both models were riddled with inaccurate assumptions and other flaws. In briefing and oral argument, much effort was devoted to undermining plaintiffs' essential assertions that the lost profits shown by the models were both reasonably foreseeable and established with reasonable certainty.

Because we conclude that plaintiffs could have and, in fact, did mitigate damages potentially flowing from the en-

actment of FIRREA, we do not dwell on defendant's evidence and argument concerning foreseeability or reasonableness of lost profits. Since actual mitigation or a failure to take reasonable steps to avoid damages would preclude recovery of damages even if shown to be foreseeable and (if not avoided) reasonably certain, there is no occasion to analyze at length the parties' evidence and arguments concerning foreseeability and certainty.

(Notwithstanding, we observe in passing the following. Concerning foreseeability, *see generally* Restatement (Second) of Contracts § 351 (1981), we conclude that although lost profits from the FIRREA impacts were foreseeable as a general matter, the magnitude of damages which the lost-profit models purport to show was not reasonably foreseeable. *See Landmark Land Co. v. United States*, 256 Fed.3d 1365, 1378 (Fed. Cir. 2001); Restatement (Second) of Contracts § 351, comment a. Concerning reasonable certainty, *see generally* Restatement (Second) of Contracts § 352 (1981), (1) we conclude that the models are based upon inaccurate assumptions about plaintiffs' plans for growth of Bank United and management's selectivity in using its leveraging capacity, and (2) we further conclude that the models are filled with speculation upon speculation and thus do not establish lost profits with reasonable certainty.)

VI

Concerning damages, a contracting party's expectancy interest is the "interest in having the benefit of his bargain by being put in as good a position as he would have been in had the contract been performed." Restatement (Second) of Contracts § 344(a) (1981). Expectation damages are generally measured by the "loss in the value to [the injured party] of the other party's performance caused by its failure or deficiency, plus . . . any other loss, including incidental or consequential loss, caused by the breach . . . ." Restatement (Second) of Contracts § 347 (1981).

The rule for mitigation is found in section 350 of the Restatement (Second) of Contracts, entitled "Avoidability as a Limitation on Damages," which provides:

> (1) Except as stated in Subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation.
>
> (2) The injured party is not precluded from recovery by the rule stated in Subsection (1) to the extent that he has made reasonable but unsuccessful efforts to avoid loss.

Comment a to section 350, concerning the rationale for the section, states that it encourages a potential plaintiff "to make such efforts as he can to avoid loss by barring him from recovery for loss that he could have avoided if he had done so." Comment b to the section provides: "As a general rule, a party cannot recover damages for loss that he could have avoided by reasonable efforts."

VII

At the outset of any discussion of plaintiffs' entitlement to damages for the breach resulting from the enactment and implementation of FIRREA, it is essential to identify precisely the harm which resulted from the breach.

The clear, direct and immediate harmful impact of FIRREA upon implementation was significant loss of borrowing capacity. This was the only clear and direct loss suffered by plaintiffs. Stated in balance-sheet terms, this immediate loss may be stated as a significant reduction in capital ratio. But such reduction in borrowing capacity, standing alone, did not result in immediate economic harm.

An important point is that FIRREA did not cause Bank United to lose or lose the use of any investable asset which it had at time of breach. Every dollar which Bank United had upon implementation of FIRREA for investment or for use as collateral was unaffected by FIRREA. No actual investable assets were taken or rendered unusable. The loss to plaintiffs, to Bank United in particular, was reduction of the bank's borrowing capacity.

A reduction in capital ratio has the potential to cause economic harm only because it *ipso facto* reduces borrowing capacity. (Of course, a reduction in capital ratio sufficiently severe to cause a bank to fall out of capital compliance could result in closure by bank regulators and resulting adverse financial consequences, but the breach did not cause Bank United to fall out of capital compliance.)

The reduction in capital ratio did not immediately and directly result in lost profits. Even under plaintiffs' theory and models, no profits could have been lost unless and until Bank United would have—but was unable to as a result of lost leverage capacity—actually used the leverage capacity by borrowing, reinvesting and achieving a positive rate spread.[11]

We do not mean to suggest that the reduction in capital ratio was not a serious harm which had the potential for adversely affecting plaintiffs' growth plans, but the reduction did not immediately cause any loss of "tangible" assets.

Thus, at the time of FIRREA's impacts, plaintiffs became entitled to the cost of restoring the borrowing capacity (capital ratio) eliminated by FIRREA in a way that would allow Bank United to pursue its intended growth and profit-making plans. In a case of this nature, such damages are the same as the costs of mitigation. This is the "make whole" remedy to which plaintiffs were surely entitled.

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[11] The value of leverage is in the potential for profits. Leverage, of course, also has the potential for loss if rate spreads are negative, but when a bank loses even the opportunity to take that risk, something of value has been lost, especially for an institution whose reason for being is to borrow at one rate and to lend (or otherwise invest) at a higher rate. *Glendale Federal Bank, FSB v. United States*, 239 F.3d 1374, 1382 (Fed. Cir. 2001). If leverage did not have value, plaintiffs would not have bargained for the capital forbearance, subordinated debt and supervisory goodwill provisions. *See id.* at 1382.

(As a matter of arithmetic, capital ratio can be restored by a reduction in assets, using the proceeds of such reduction to correspondingly reduce liabilities, or by acquiring capital, i.e., assets without offsetting liabilities. For a bank seeking growth, the desirable way to restore lost capital ratio is acquisition of capital, and this path was chosen by Bank United.)

VIII

A

Plaintiffs assert that if they are not entitled to lost profits because they could have mitigated the impacts of the breach, they are at least entitled to the hypothetical costs which would have been incurred to accomplish complete mitigation. Plaintiffs submitted a cost-of-substitute-capital model to calculate the costs to infuse the substitute capital necessary to mitigate the lost leverage caused by the breach. Plaintiffs claim $117 million in damages to recover the alleged costs of raising the hypothetical replacement capital. Pl. Br. (12/15/99) at 87-88. *See generally*, 3 Dan B. Dobbs, Law of Remedies § 12.6(2), at 141 (2d ed. 1993); Restatement (Second) of Contracts § 350 illus. 5-8 (1981).

The cost-of-substitute-capital model posits that Bank United would have needed to raise approximately $228 million in substitute capital in December 1989 to offset the deficiency created by the breach. Tr. 2930 (Myers). The model first calculates the maximum assets that could have been supported with the three forbearances in place. Next, it calculates the maximum assets that Bank United could support after FIRREA passed and the forbearances were eliminated. The difference between these two numbers is then considered to be the lost leverage caused by the breach. The model next determines the amount of additional capital that Bank United would have required to support the same amount of assets after the breach as before the breach. It concludes that $228 million in additional capital was needed to regain the leverage capacity lost as a result of FIRREA.

The model then calculates the cost that Bank United would have incurred to fund a hypothetical December 1989 issuance of preferred stock, positing a minimum dividend rate of 20 percent to attract investors. The model assumes that the proceeds of the hypothetical issuance would either be used to pay down borrowings or be invested in risk-free government bonds earning approximately 7.0 percent after tax. PX 728. The model assumes that Bank United would have paid the 20 percent dividend on the preferred stock each year and would have earned roughly 7.0 percent on the risk-free bonds. PX 728. The model calculates the resulting negative "dollar spread" on a quarterly basis, PX 302, table 2-5, which, accumulated over a period of years, yields damages of $117 million. Such alleged damages consist of $74 million in net loss, including $10.7 million in transaction costs, which are then grossed-up by $43 million to account for taxation of the award.

B

Plaintiffs certainly are entitled to recover the costs they incurred in actually mitigating and the proven costs of what would reasonably have been incurred to mitigate, but such costs are grossly exaggerated by this model.

There are several defects in the model. At the outset, the suggestion that it would cost $117 million to raise $228 of capital is absurd on its face. The most serious flaw in this model is its assumption that all of the lost ratio would have to be restored immediately in December 1989 to forestall economic harm. But an immediate infusion was not required to mitigate and could have been accomplished, as it was, on a piecemeal basis as and when it appeared to be desirable to take advantage of investment opportunities. *See* JX 39; DX 1017.

The model fails to consider the nature and limited extent of the breach impacts upon Bank United, the fact that the full impact of the breach did not occur at once but was to be phased in over several years, the fact that the plaintiffs were perhaps uniquely capable of calling in capital commitments

in large amounts on short notice, and the fact that the plaintiffs did mitigate at a cost vastly less than that projected by the model.

IX

A detailed discussion of the breach impacts will assist in understanding precisely what needed to be mitigated, whether it was reasonable to mitigate the impacts and the timing of mitigation necessary to avoid economic harm.

The mitigation-cost model assumes the need for full capital replacement as of December 1989, i.e., the immediate and "permanent" replacement of $228 million which the model calculates as the new equity needed to compensate for (1) the additional 1.0 percent of capital ratio required upon implementation of FIRREA's 3.0 percent capital-ratio requirement, (2) inability to count the $110 million of subordinated debt as capital and (3) loss of ability to count $30 million of supervisory goodwill as regulatory capital.

A

The capital forbearance agreement, although potentially providing regulatory forbearance for ten years, would have permitted enforcement of a minimum capital ratio of 2.5 percent during 1991 and 3.0 percent (the level required by FIRREA) as of the beginning of 1992, expressed as a percentage of liabilities (and consequently slightly lower than if expressed as a percentage of assets as required under FIRREA). Consequently, with respect to the capital forbearance agreement, the significant impact of the breach was the requirement of a minimum capital ratio of 3.0 percent during 1990 and 1991 instead of 2.0 percent during 1990 and 2.5 percent during 1991. By the end of 1992, the ratio level the capital forbearance agreement would have permitted (3.5 percent of liabilities) was above that required under FIRREA (3.0 percent of assets). *See* JX 11.

B

Concerning the subordinated-debt impact, although Bank United suffered a severe reduction in capital ratio upon

implementation of FIRREA's prohibition of counting such debt as regulatory capital, the plaintiffs had the capacity to cure the problem by making a swap of subordinated debt for equity among themselves. Plaintiffs accomplished such an exchange at a cost less than $5 million, yet this swap alone accounted for approximately half of the amount of new equity assumed to be needed in December 1989.

As part of the December 1988 transaction, plaintiffs were required to invest $200 million in the new thrift, of which $110 million would constitute a subordinated-debt obligation of the bank but could nonetheless count as regulatory capital. JX 10; JX 11 at ¶ 1; *see also* JX 15 at 341; PX 600. Bank United issued the subordinated debt on May 24, 1989 with an interest rate of 15 percent. DX 1017.

In order to compensate for the capital depletion caused by FIRREA's elimination of the ability to count the subordinated debt as regulatory capital (rather than as a liability), plaintiffs promptly initiated action to exchange the bank's subordinated-debt obligation for "Senior Notes" issued by USAT Holdings Inc. USAT Holdings assumed the bank's obligation to repay and deemed the proceeds of the subordinated debt to be "infused" as equity into Bank United. The exchange transaction was completed in September 1990.[12]

For plaintiffs to exchange the subordinated-debt obligation for Senior Notes, the noteholders had to be convinced to move the debt obligation from the bank to the holding company. Having debt at the holding company level was more risky for investors since the only way the holding company could pay interest or principal was by receiving dividends from the bank, which were subject to regulatory approval and other restrictions. Pl. Br. (12/15/99) at 27; PX 604. Consequently, the Senior Notes carried an interest rate of 15.75

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[12] Precise details of the exchange transaction are set forth in DX 1017, ¶ 5.

percent, JX 6; DX 1017, a rate higher than the bank would have paid on the subordinated debt.

C

Concerning FIRREA's alteration of the amortization period for supervisory goodwill, the full amount of supervisory goodwill permitted to be counted as capital was not lost upon passage or implementation of FIRREA. Rather, elimination of goodwill as regulatory capital was to be phased in over five years instead of over twenty-five years as plaintiffs had been promised. This meant that instead of being permitted to amortize the $30 million of goodwill at a rate of $1.2 million per year over 25 years, the bank was required to amortize $6 million a year over five years. Thus, the first-year impact of FIRREA upon the supervisory goodwill agreement was to require amortization of $4.8 million more than had been agreed, and the model's full replacement of $30 million in December 1989 overstates the loss.

Further, Bank United wrote off the FIRREA-impaired supervisory goodwill on September 30, 1993, 15 months earlier than required by FIRREA, as a result of the Financial Accounting Standards Board's (FASB) adoption of Statement of Financial Account Standards No. 109 (SFAS 109). SFAS 109 required that Bank United write off all supervisory goodwill on its GAAP financial statements in order to use net operating loss carry-forwards to reduce taxes. PX 627.[13]

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[13] On January 20, 1993, the OTS issued Thrift Bulletin No. 56 requiring that supervisory goodwill written off for GAAP also be written off under regulatory accounting principles (RAP). OTS Thrift Bulletin 56, 1993 WL 22198 (Jan. 20, 1993)

Plaintiffs assert that if defendant had not already breached, Bank United could have kept the supervisory goodwill on its books as an asset that counted towards capital notwithstanding SFAS 109 and could have continued to leverage the supervisory goodwill to acquire more assets. PX 627. In support of their assertion, plain-

[Footnote continued on next page]

Bank United wrote off the supervisory goodwill in order to comply with FSAS 109 and to gain the benefit of using its NOLs to reduce its taxes.

During the entire damages window between 1989 and 1992, plaintiffs had use of some of the goodwill forbearance, although in 1990, 1991 and 1992, the goodwill had to be reduced at the rate of $6 million a year instead of $1.2 million. Thus, as of the end of 1990, the goodwill was reduced to $24 million, as of the end of 1991 to $18 million, and as of the end of 1992 to $12 million.

D

To summarize the significant capital-ratio impacts of FIRREA upon Bank United, (1) for 1990 and 1991, the bank was required to maintain a ratio or 3.0 percent, rather than 2.0 percent in 1990 and 2.5 percent in 1991 as would have been permitted under the capital forbearance agreement, (2) between the implementation of FIRREA and September 1990, the bank lost the ability to count a $110 million debt obligation as regulatory capital, and (3) for voluntarily elimi-

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[Footnote continued from previous page]

tiffs cite the forbearance agreement which states in paragraph 7 subpart E: "Amortization of goodwill, whether or not resulting from the acquisition of the Acquired Institutions, shall not be accelerated as a result of the utilization of net operating loss carryforwards for tax purposes or other tax allocations." JX 11, ¶ 7; PX 627.

However, Thrift Bulletin No. 56, which adopted SFAS 109, merely made OTS regulations consistent with FASB requirements. Bank United was not required to comply with SFAS 109, but chose to in order to take advantage of its NOLs, knowing that such compliance would require writing off the supervisory goodwill. Bank United's decision to comply with an accounting standard that had no connection with FIRREA cannot be transformed into damages from a loss of the ability to leverage supervisory goodwill.

nated), the bank was required to amortize the initial supervisory-goodwill asset of $30 million at the rate of $6 million per year instead of $1.2 million.

X

It is appropriate in a discussion of plaintiffs' mitigation to examine what plaintiffs intended to achieve for Bank United with the bargained-for provisions concerning capital forbearance, subordinated debt and supervisory goodwill and to then compare what Bank United actually achieved after the breach which adversely impacted the bank's borrowing capacity.

A

As part of the December 1988 acquisition process, Hyperion Partners L.P. submitted a holding company application (HCA) which included a business plan for the thrift it intended to operate and financial projections detailing the intended operating strategy. DX 794A. Thereafter, Bank United was subject to significant reporting requirements from its inception. Tr. 289, 293-95 (L. Ranieri).

Business plans submitted pursuant to regulatory requirements are evidence of a bank's intended operating strategy. Banking is one of the most highly regulated industries, and business plans are an important part of the regulatory review process. Tr. 4489 (Bankhead). Regulators rely on the information in business plans as part of the "off-site" monitoring of a thrift. *Id.* Business plans also assist bank regulators in conducting "on-site" monitoring. Tr. 4489-90 (Bankhead).

The business plans discussed below show that plaintiffs intended to operate Bank United as a traditional retail savings institution. DX 794A. The actual performance of Bank United was consistent with the stated intentions in the business plans.

B

The HCA was submitted by Hyperion Partners L.P. prior to acquisition of what would become Bank United. DX 794A. The HCA proposed that Bank United would be a well-capitalized thrift growing through a retail strategy supplemented by wholesale purchases. DX 794A. This business plan was submitted prior to introduction of the legislation that eventually became FIRREA. It also was prepared before the managers of what would become Bank United had the opportunity to fully examine the books and records of the failed thrift. Thus, the HCA provides insights into the general strategy foreseen by the investors and testified to at trial. This general strategy is consistent with business plans and operations after the introduction of the breaching legislation

Throughout 1989, Bank United created several business plans projecting the thrift's growth strategy. Each of these plans projected a well-capitalized thrift primarily focusing on retail growth supplemented by wholesale purchases. *See* DX 799; JX 46; DX 800; DX 801.

The first business plan drafted after the acquisition was completed in January 1989, DX 799, projected Bank United's capital ratio to be approximately 4.4 percent of liabilities (approximately 4.2 percent of assets) and projected average annual growth of approximately $800 million in various types of assets. DX 799 at BU506785-87. The growth was to be funded with fixed-maturity deposits. Def. Br. (12/15/99) at 12. On March 28, 1989, Bank United prepared a second business plan substantially similar to the January plan. JX 46 at BU201365-66, 201369, 201374.

Bank United prepared a five-year projection dated April 7, 1989 either in conjunction with the placement of the subordinated debt or in response to the regulators. DX 800; Tr. 1001 (Shay). This business plan, like the two before it, proposed to maintain a well-capitalized thrift with a capital ratio between 5.11 to 7.69 percent over five years and to grow the deposit side of the institution. DX 800 at BU506800; Def. Br. (12/15/99) at 12.

Subsequent to enactment of FIRREA, Bank United closed wholesale-asset purchases on December 7, 1989 for a $65 million package of mortgages sold by Prudential and for a $70 million purchase from Bear Stearns three weeks later. This activity shows that Bank United intended to and did grow through wholesale purchases when management thought it desirable.[14] PX 323. However, management testified that building a retail franchise was a goal for Bank United. Tr. 331 (L. Ranieri). L. Ranieri testified that after the breach "[w]e wound up with 18 branches and that wasn't enough . . . [;] [t]he house was half built." Tr. 331 (L. Ranieri). Bank United's 18-branch franchise was "not a business to build anything [upon]." Tr. 332 (L. Ranieri). "[C]ustomers give you lots of opportunities to make money, not simply as a function of cost of funds." *Id.* Shay testified that the plan was to "really grow the retail deposit network," that "we thought there was an opportunity . . . to build a strong deposit franchise in Texas," and that "we also wanted to build the asset side of the balance sheet using traditional one-to-four family loans, mortgagebacked securities and the like . . . ." Tr. 753 (Shay).

C

There was convincing evidence that Bank United began pursuing wholesale purchases only after disintermediation in the retail market at the end of 1992. Nocella testified that "what happened is deposits throughout the United States, including Texas, have not grown." Tr. 1385 (Nocella). Nocella attributed this lack of growth to industry-wide disintermediation:

> [W]e made an assumption that deposits would grow. This world of deposits stopped growing 10 years ago. Throughout the United States, just like mortgages were

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[14] At the time of these purchases in December 1989, Bank United's capital ratio was 3.60 percent. PX 302 at BU950538.

> securitized, deposits were securitized. They were called mutual funds and all the 401(k)s were taken out. Everybody had a CD and a 401(k). That's all gone away. They're in mutual funds. And deposits declined. We thought deposits were going to grow over time. Every year, we hoped deposits would grow by 2 percent, 3 percent, 4 percent. They never grow.

Tr. 1444 (Nocella). In its 1993 10-K Bank United stated:

> The Bank increased the amount of FHLB advances and securities sold under agreements to repurchase [up] to $2.5 billion at September 30, 1993, from $632.3 million at September 30, 1992. The Bank's utilization of FHLB advances as a funding source reflects the difficulties the institutions are having in attracting and maintaining deposits resulting from a low interest rate environment.

JX 65 at BU139595.

Bank United began focusing on wholesale borrowing only after the RTC stopped selling thrifts and depositors began leaving thrifts for more lucrative returns in mutual funds and other investments. Def. Br. (12/15/99) at 25.

D

The contemporaneous evidence indicates that Bank United pursued a plan, first expressed in the HCA and never contradicted in any subsequent business plan, nor by the actual bank, to first grow its retail base and to supplement its growth with wholesale purchases. Only after disintermediation in the retail market occurred, did Bank United significantly increase its wholesale purchases.

XI

As stated above, the three breach impacts of FIRREA were (1) elimination of the ten-year capital forbearance agreement, (2) elimination of the authorization to count subordinated debt as regulatory capital and (3) significant shortening of the amortization period for supervisory goodwill.

Soon after enactment of FIRREA, before the effective date of implementing regulations, plaintiffs initiated steps to mitigate potential damage from the resulting lost leverage. Actions to mitigate continued throughout the damages window.

Plaintiffs were able to raise capital to pursue opportunities they thought worthy despite FIRREA and other obstacles which made raising capital from public offerings difficult for Bank United.

A

As a result of FIRREA and the anticipated impacts of the contract breach, Bank United sought to raise capital, and plaintiffs undertook a conversion of the subordinated debt into equity.

In late 1989, Bank United tried to raise $50 million in additional capital through a private placement of noncumulative preferred stock (which would count as equity). JX 5; Tr. 802-04 (Shay). To that end, Shay hired Salomon Brothers, retained a law firm and had a prospectus prepared. JX 5; Tr. 802-05 (Shay). Bank United hoped to be able to place the offering at a 14 percent dividend rate. Pl. Br. (12/15/99) at 25. Prospective buyers shown the prospectus responded that they would require a 20-25 percent rate. Tr. 805-06 (Shay); Pl. Br. (12/15/99) at 25. Plaintiffs claim that they were unable to issue preferred stock before December 1992. Tr. 810-12 (Shay).[15]

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[15] Defendant argues that there are no contemporaneous documents confirming that Bank United tried to issue the stock or that investors were demanding a 20-25% dividend rate. We find Shay's testimony on this issue credible and supported by the facts that investment bankers were hired, a prospectus was prepared and a placement did not occur until December 1992. In addition, there was testimony by several witnesses, including a defense witness, that during the renegotiation period it was difficult for any thrift to

[Footnote continued on next page]

In December 1992, Bank United raised $85.5 million of equity capital through the issuance of 3,420,000 shares of noncumulative preferred stock at a rate of 10.12 percent. JX 7 at 1; JX 39 at 1. This stock issuance resulted in a net capital acquisition of $82.5 million after deduction of $2,992,500 in commissions; the bank incurred $950,000 in other expenses related to the issuance. JX 7 at 1 & n.3; JX 39; DX 1240A.

After the breach, plaintiffs restructured the bank's subordinated debt as debt ("Senior Notes") of USAT Holdings Inc. The converted $110 million was then downstreamed to Bank United as equity and thus counted towards fulfilling the regulatory capital-ratio requirement. PX 603; Tr. 762-64 (Shay). This conversion was completed on September 27, 1990. DX 1017, ¶ 5. Plaintiffs incurred $4,884,283 in various costs to accomplish conversion of the bank's subordinated debt into equity. PX 302, table AD-1; PX 718.

[Footnote continued from previous page]

raise capital. Tr. 1603-06 (Wood); *see also* PX 421 at BU949608; PX 424 at BU946326; PX 426 at BU949601 (government officials testifying before Congress as to the declining value of thrifts as a result of FIRREA). Further, after the subordinated debt exchange, interest payments on the Senior Notes were paid directly by USAT Holdings Inc. PX 604. Dividends from Bank United to fund such interest payments had to be approved by OTS and were subject to capital regulations and income tests. *Id.* This preexisting need for dividends would likely concern investors.

Defendant counters that three other Southwest Plan thrifts raised capital during this period. Def. Br. (12/15/99) at 34; DX 1250; Tr. 3527-28 (Fischel). While this is apparently true, it does not undermine our acceptance of Shay's testimony concerning the 1989 effort to raise capital through an offering of preferred stock.

B

In May 1990, while the subordinated debt exchange was being implemented, United Savings Association of the Southwest (USAS) was formed by plaintiffs under a "hold separate" agreement when regulators from the RTC informed Bank United that it could not bid on failed thrifts while plaintiffs' contract with defendant was under review pursuant to § 501 of FIRREA. Tr. 1801-03 (Nocella); JX 17; DX 902; DX 911; DX 914. After 16 months, during which capital infusions were made into USAS and the entity acquired three thrifts, USAS was merged into Bank United on September 30, 1991. JX 39 at 8-10 (BU114804-09); DX 1017, ¶ 7. Thus, for purposes of evaluating plaintiffs' mitigation of damages and execution of business plans, it is appropriate to consider the capital infusions into USAS and the activities of that entity as if USAS and Bank United were a single institution. *See id.*

Three thrifts were purchased through USAS: Ameriway Savings on May 14, 1990, Murray Federal Savings on June 8, 1990 and Metropolitan Financial Savings on June 22, 1990.

USAS was initially capitalized with $4.2 million from USAT Holdings Inc. to finance the purchase of Ameriway Savings. DX 936; DX 1017; JX 39. Hyperion Partners L.P. borrowed these funds from Bank of New York (BONY) and lent them down the chain to USAT Holdings which infused the funds into USAS as equity. DX 1017. The BONY loan was repaid with a Hyperion Partners L.P. capital call on June 30, 1990. DX 936; DX 1017.

The purchases of Murray Savings and Metropolitan Savings were funded by a $40.1 million capital call from Hyperion Partners, L.P. and a $47.8 million bridge loan from BONY to Hyperion Partners L.P. and lent down the chain to USAT Holdings Inc. DX 936; DX 1017; DX 1240A. It would not have been necessary for Hyperion Partners to borrow this money and flow it down the chain and into USAS as

equity had FIRREA not breached the subordinated debt forbearance and the capital forbearance.

C

In December 1990, the OTS required Bank United to take a reserve of $43 million against its junk bond portfolio until the FDIC determined whether the junk bonds were covered assets under the Assistance Agreement.[16] PX 447; DX 948; Tr. 823-25 (Shay). Discounting for this reserve put Bank United temporarily out of capital-ratio compliance and (if, as a result, the bank could not pay stock dividends) could have caused USAT Holdings Inc. to default on the Senior Notes for which the subordinated debt had recently been swapped. Tr. 823-25 (Shay); Tr. 1610-13 (Wood); Tr. 1904 (S. Ranieri); Tr. 4047-49 (Jones); PX 616.

In order for the bank to remain in capital-ratio compliance while the junk bond dispute was being resolved, plaintiffs infused $15 million of new capital into the bank on December 31, 1990. JX 39; DX 1017.

D

On another occasion, a capital infusion was made when Bank United purchased two failed thrifts from the RTC in

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[16] Bank United received a Management Assets Capital Risk Management and Operating Results rating of 3 (MACRO 3) in a regulators' Report of Examination (ROE) commenced in August and completed in November 1990. PX 618 (MACRO ratings range from 1 to 5, 1 being the highest rating); Tr. 1145 (Shay). The ROE indicated that "[s]erious deficiencies . . . in the overall management of assets" combined with "the substantial unrecognized credit risk in the junk bond portfolio . . . are the driving factors warranting this conclusion." PX 618; Tr. 1143-45; JX 122. On February 20, 1991, the FDIC determined that the junk bonds were covered assets. However, OTS regulators did not remove the low rating. Tr. 1619-21, 1704-05 (Wood); PX 392; PX 449; PX 450.

order to grow its retail franchise. On December 19, 1991, $16.1 million was infused for the purchase of San Jacinto Savings and Banc Plus Savings. Tr. 827 (Shay); PX 632; DX 1017; DX 1240A.

E

The above-described capital infusions during the damages window, not including the conversion of $110 million of subordinated debt into equity, amounted to $208.739 million.

The capacity of these plaintiffs to mitigate quickly and effectively at minimum cost may be unique among *Winstar* plaintiffs. The Hyperion Partners L.P. partnership agreement allowed for up to one third of the initial total of $434 million in capital commitments (approximately $145 million) to be invested in Bank United. Actual use of capital commitments during the damages window to expand the retail franchise is demonstrated in the above descriptions of equity infusions into Bank United.

F

Plaintiffs were in a position such that it was not necessary, to avoid suffering harm from the lost leverage, to immediately replace all the lost leverage by a single mass infusion of capital. They were in a position, because of capacity to make capital calls on short notice, to wait until there was a reason to commit new capital to the bank before doing so. In all instances, when there was a reason to commit new capital to pursue a good opportunity, plaintiffs did it. They fully mitigated to the extent that they deemed it desirable to do so.

G

In sum, plaintiffs had a duty to mitigate the lost leverage and they did mitigate. We find that not only could plaintiffs have easily mitigated the loss of leverage capacity by infusions of capital, they actually did so. JX 39; DX 1017; DX 1240A. The plaintiffs' actual mitigation enabled them to pursue their planned retail strategy and to pursue a wholesale strategy to the extent that assets could be found meeting the

plaintiffs' criteria. See Part XII below. When there were profitable opportunities available in the retail market, plaintiffs mitigated by infusing capital into Bank United or operating the bank at a lower capital ratio, but argue now that mitigation to pursue a wholesale strategy was too risky.

The fact that the bank performed consistently with the projections in the business plans demonstrates that Bank United successfully pursued its intentions to build a retail franchise in the early years. Tr. 4497 (Bankhead). This is consistent with plaintiffs' testimony that they planned initially to develop the retail franchise. Plaintiffs' testimony that Bank United had a wholesale department and made some wholesale acquisitions between 1989 and 1992 is not inconsistent with the retail strategy outlined in the business plans. Using deposits from the retail acquisitions to acquire wholesale assets was consistent with a retail growth strategy. Tr. 4517 (Bankhead).

XII

During the damages window, the breach impacts did not prevent Bank United from successfully pursuing its forecasted business operations, including retail growth supplemented by wholesale purchases. Further, Bank United had the financial ability to increase its wholesale assets during the damages window but determined that appropriate wholesale purchases were not available.

This is demonstrated by the fact that during significant periods of the damages window, instead of being constrained by the FIRREA-imposed capital ratio, Bank United operated from an underleveraged position and chose not to take full advantage of excess liquidity.

A

Two factors demonstrate that FIRREA did not prevent plaintiffs from pursuing any growth or investment strategy which they wanted Bank United to pursue. First, there is significant evidence that during the damages window, Bank United frequently operated from an underleveraged position

and had difficulty deploying excess liquidity. Thus, even though Bank United had the ability to pursue more investments, including wholesale investments, than it actually did, there were frequently no assets in the market that satisfied its risk and yield criteria. Second, when profitable retail opportunities arose, Bank United pursued them even if it required borrowing or infusing capital (see Part XII above), or operating at a lower-than-planned capital ratio.

B

Between 1989 and 1992, Bank United was often underleveraged, had excess liquidity, and could not find appropriate assets to purchase with excess cash, all as demonstrated by board-of-directors minutes, asset/liability management committee (ALCO) minutes and other contemporaneous documents.[17] *See* DX 1159 (total cash received from covered assets and the RTC).

Even though Bank United needed to deploy excess liquidity to maximize income, it was often unable to do so because there was a "lack of high quality assets" available in the market. JX 143 at BU143206-07 (balance sheet footings less than planned "due to the nonavailability of high quality assets in the market").

The difficulty in finding high quality assets was exacerbated by Bank United's strict credit and performance standards. L. Ranieri testified that "one of the reasons that the bank was periodically underlevered was because it could not find assets . . . that met its investment criteria." Tr. 492 (L. Ranieri). Bank United "set very high objective standards for both credit and the yield that we want to obtain on the assets we buy." Tr. 618 (L. Ranieri). The aim of Hyperion Partners

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[17] For examples—beyond those discussed in text—of instances when Bank United was underleveraged and had excess liquidity, see the board-minute summaries provided in DX 1167.

L.P. was to have an internal rate-of-return of 30 percent per year.[18] Tr. 585-86 (L. Ranieri).

The April 5, 1990, board meeting minutes confirm the difficulty Bank United had in locating assets and the fact that it would not reduce its credit standards:

> The Chairman added that the Corporation is being very careful in the acquisition of whole loan packages even though the corporation is currently underlevered. Mr. Thorn added that the Corporation has not relaxed its high credit standards and that a large number of prospective whole loan purchases which are reviewed are rejected.

JX 141 at 4.

Except for the testimony of Bank United's managers, there is no evidence in the record supporting the proposition that Bank United would have lowered its credit or return requirements.[19] These were excellent managers who negotiated Bank United through a difficult time for the thrift industry when many less well-managed thrifts failed.

During this same period, Bank United was not constrained by the breaches in pursuing its retail strategy. Bank United pursued its goal of growing its retail base just as forecasted in its business plans. Bank United bid on "every [RTC] acquisition that came up in Houston or Dallas/Fort Worth, and some we won and some we lost but we bid on everything there was." Tr. 633-34 (L. Ranieri); *see also* Tr.

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[18] The venture capital internal rate-of-return (IRR) target of 30 percent per annum was not achieved. At the time Bank United went public, the annual IRR's had been approximately 24 to 25 percent. Tr. 586 (L. Ranieri).

[19] Bank United had the capacity to buy additional assets but would not reduce its credit standards and, thus, lost bids or was unable to find suitable assets to purchase. Tr. 4505 (Bankhead); *see also* JX 141.

1393-94 (Nocella) (Bank United was "eager to bid on the sale of RTC deposit liabilities from failed thrifts in Texas"). L. Ranieri testified that he did go to the partners for additional capital after the breaches "where it was necessary to either protect the 200 [million dollar investment] or finish building the [retail] platform." Tr. 353. Although L. Ranieri also testified that he did not go back to the partners for capital to replace leverage lost as a result of the breach impacts because there were concerns about the ultimate survival of Bank United and he would consider it "throwing good money after bad," Tr. 357-58 (L. Ranieri), the plaintiffs' contemporaneous conduct is inconsistent with such concern.

Shay testified that Bank United "constantly" considered calling additional capital to acquire institutions in the fall of 1989 and into 1990. Tr. 839 (Shay); DX 895 (internal memorandum listing banks that Bank United was interested in acquiring). Bank United bid upon large institutions that, had it won the bids, would have required infusions of between $50 and $100 million. Tr. 4704-05 (Bankhead) (explaining University Savings bid); *see also* Tr. 463 (L. Ranieri) ("If we made a bid, we would obviously honor the bid."); *accord* DX 881.

C

Bank United's purchase of thrifts from the RTC added to the problem of excess liquidity (as a result of the acquired deposits). In May and June 1990, three thrifts were purchased through USAS, Ameriway Savings, Murray Savings and Metropolitan Savings. Initially, this precipitated a drop in Bank United's capital ratio, but a run-off of acquired deposits pushed the capital ratio back up. DX 1164. By December 1990, Bank United's capital ratio began to increase and the thrift had excess liquidity and was underleveraged. JX 226 at BU143518, BU143520; JX 227 at BU143549.

At a September 1990 board meeting, approximately one year into the damages period, Nocella explained that the thrift continued to be plagued with excess liquidity. JX 224 at BU143477 (Bank United "had invested this excess liquid-

ity in quality assets as prudently and quickly as the market would allow, but a large balance remained"); *see also* JX 225 at BU 143500 (in October 1990, Nocella stated that "the biggest problem" facing Bank United was the "excess liquidity" created by the acquisition of the three thrifts). Even by March 1991, almost half way through the damages period, Bank United had not been able to deploy its excess cash. Nocella reported to the board that "earnings were $2 million under budget and this was caused by excess liquidity which was expected to have been invested two months earlier than it was." JX 229 at BU143582.

Bank United's underleveraged position continued through May and July 1991. DX 778; *see* DX 988. L. Ranieri testified that if "appropriate" assets had been available, Bank United could have remedied its underleveraged position by leveraging its unused capital to borrow on the wholesale markets and purchase wholesale assets. Tr. 501 (L. Ranieri).

In 1991, Bank United purchased three more thrifts from the RTC, BancPLUS Federal Savings on September 20, 1991; San Jacinto Savings on September 27, 1991; and the San Antonio branch of Victoria Savings on October 25, 1991, acquiring more than $2 billion in cash and expanding its retail franchise. JX 65 at BU139533. These acquisitions (and their resulting acquired deposits) required Bank United to deploy its excess cash through purchases of wholesale assets.

As shown above, Bank United's operation during the damages window demonstrates that when a profitable retail opportunity arose, it was pursued. The fact that additional wholesale assets were not purchased even though Bank United had the capacity to acquire them, indicates that Bank United did not find any wholesale investments which met its criteria.

D

The evidence shows, and witnesses concede, that they pursued every retail opportunity available and would be will-

ing to infuse money to guarantee the survival of Bank United, at least through retail purchases. On the other hand, management testified that infusing money to pursue the wholesale strategy, which according to one of the lost-profits models would result in hundreds of millions of dollars of foreseeable profits, was considered too risky. Tr. 357-58 (L. Ranieri). Further, even when there was capital or leverage available in the bank, so that it would not be necessary to turn to the partners, Bank United did not use it to purchase wholesale assets.

The evidence also shows that Bank United was unable, for significant periods of time, to locate satisfactory wholesale assets. Further, there is no contemporaneous evidence that it ever lacked funds or leveraging ability to purchase assets that it did wish to pursue. Plaintiffs' assertion that the breach impacts prevented Bank United from using leverage capacity to purchase wholesale assets for growth is undercut by the fact that Bank United declined to buy such assets with the excess cash it had.

XIII

Plaintiffs are entitled to recover their actual costs incurred in mitigation of the lost leverage capacity caused by FIRREA. The proven mitigation costs are those incurred in connection with the conversion of Bank United's subordinated debt into equity in 1990 and the issuance of preferred stock in 1992.

The total amount plaintiffs claim for conversion of the subordinated debt is $4,884,283, comprised of $181,000 in legal fees, $1,693,283 in interest paid on a BONY bridge loan and $3,010,000 in additional interest paid on the Senior Notes. PX 301 at BU950522; PX 390; PX 718. We find that plaintiffs would not have incurred such added interest cost had defendant not breached. We conclude that plaintiffs are entitled to recover the total costs claimed for mitigating the subordinated-debt impact of the breach.

The December 1992 issuance of 3,420,000 shares of noncumulative, preferred stock which raised $85.5 million of

equity capital, JX 39 at 1, 15, caused Bank United to incur $2,992,500 in commissions; the bank incurred $950,000 in other expenses related to the issuance. JX 7 at 1 & n.3. *See generally Bluebonnet Savings Bank v. United States*, No. 00-5128, slip op. at 16-17 (Fed.Cir. Sept. 21, 2001). Thus, plaintiffs are entitled to recover a total of $3,942,500 in connection with this mitigation.

Plaintiffs further mitigated throughout the damages window by various other infusions of capital into Bank United. *See* JX 39; DX 1017; DX 1240A. Plaintiffs would have been entitled to any proven costs incurred in connection with these mitigation infusions of capital and in connection with its aborted efforts to issue preferred stock in late 1989, but no evidence of costs related to such additional infusions and efforts was presented. Thus, there is no record on which to base an award for those mitigation activities.

In sum, we conclude that plaintiffs are entitled to damages totaling $8,826,783 for the cost of mitigating the breach.

XIV

Based on the foregoing, plaintiffs are entitled to judgment in the amount of $8,826,783. Pursuant to RCFC 54(d), costs shall be awarded to plaintiffs ("the prevailing party").

Notwithstanding plaintiffs' entitlements, entry of judgment shall be withheld pending notification from the parties concerning the precise entity or entities in whose favor judgment should be entered. In 1996 (subsequent to filing the complaint initiating this case), the two holding-company plaintiffs were consolidated and renamed "Bank United Corp.," and the name of the plaintiff bank was changed to "Bank United." (The designation of Hyperion Partners L.P. remained unchanged.) Pl.Br. (12/15/99) at 1, 13 n.2. *See Bank United of Texas v. United States*, 49 Fed. Cl. 1, 2 n.1. Further, we note in the attachment to Defendant's Motion to Notify the Court of Subsequent Factual Developments filed on September 1, 2000 that Bank United Corp. was then engaged in a merger transaction with Washington Mutual, Inc., Def. Mot. (9/1/00), App. *passim*, and that "[u]pon consum-

mation of the merger, the separate corporate existence of Bank United Corp. shall terminate," Def. Mot. (9/1/00), App. at 14.

The parties are requested to confer concerning the precise names of the entities in whose favor judgment should be entered and to advise the court accordingly. Thereupon, judgment will be entered in favor of such designated entities.

Based on the foregoing disposition, all currently outstanding, unresolved motions are DECLARED TO BE MOOT.

/s/
James T. Turner
Judge

APPENDIX C

IN THE UNITED STATES
COURT OF FEDERAL CLAIMS

BANK UNITED OF TEXAS, FSB, et al.,	)	
Plaintiffs,	)	Case Number
v.	)	95-473-C
The United States	)	
Defendant.	)	

Courtroom 4
Court of Federal Claims
717 Madison Place, NW
Washington, DC
Tuesday, April 16, 2002

The parties met, pursuant to the notice of the Judge, at 10:32 a.m.

BEFORE: HONORABLE JAMES T. TURNER
Judge

APPEARANCES:

For the Plaintiff:

JOHN D. TAURMAN, ESQ.
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and

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U.S. Department of Justice
Civil Division
Commercial Litigation Branch
1100 L Street, NW
Washington, DC 20530
202-307-1011

* * *

[74]

THE CLERK: All rise. Please be seated and come to order.

THE COURT: Ladies and gentlemen, I am in a position to announce my opinion at this time. It is my opinion that the Plaintiffs' postjudgment motions findings and judgment and to reopen the record for additional evidence should be denied. I'm simply not persuaded by any of the reasons entered in January.

And although in this postjudgment context, it may [75] not be incumbent upon me to state more than the concerning rationale, I do want to be clear about the reasons for rejecting the Plaintiffs' postjudgment motions.

But before I get into rationale, I'm especially concerned that no side and no one think that I'm engaging in a rush to a ruling without adequate reflection on the arguments that have been so ably presented today. The issues which have been argued today have been very well, very thoroughly briefed, and there has been adequate time for study and reflection concerning the issues before today.

Further, I have the luxury of taking the time I feel I need to reflect on the proper ruling and if you thought further reflection would change the opinion I have announced, I would take that time.

I ruled at this juncture because I strongly think that further reflection would not change the result. And on the other side of the ledger, I feel it's a benefit to all for a court to rule promptly after it is plain what the ruling will be, so that everyone affected can move on either to an appeal process or to other matters.

The crux of the Plaintiffs' postjudgment motions is that the Plaintiffs are entitled, as costs of mitigation, to reimbursement for dividends actually paid upon the December 1992 preferred stock issuance and to [76] reimbursement for the principal amount of and to payment of a hypothetical reasonable return on the capital infusions into Bank United, totalling approximately $35 million made during 1990 and 1991.

The essence of my disagreement with Plaintiffs' position is that the reimbursements they now seek are not for the transaction costs of mitigating damages, for which they most effectively accomplished, but for the money raised to pursue aims which would have required infusions or acquisitions of real cash to accomplish, even in the absence of the FIRREA breach.

It's important to keep in mind as the starting point of the analysis concerning Plaintiffs' motions that the portion of the Bank's capital ratio provided by the supervisory goodwill, and by the forbearances which Bank United lost the enactment of FIRREA, represented borrowing capacity. The FIRREA breach did not remove one dime of tangible investable money from the asset side of the bank's balance sheet, which the Plaintiffs were replacing by the capital infusions and preferred stock issuance. The new capital, insofar as mitigation is concerned, was replacing borrowing capacity, not tangible assets. The preFIRREA goodwill on the balance sheet and the forbearances did not, without more, provide any investable asset. To use a borrowing capacity which FIRREA [77] took away, Plaintiffs would have to borrow and thus incur interest expense or similar cost of funds' obligations on any sum so acquired.

Consequently, any dividends paid on the preferred stock are analogous to interest which the bank would have incurred had it instead been able to use its preFIRREA borrowing capacity.

Insofar as the Plaintiffs' position with respect to the 35 and a third million of capital infusions is concerned, I am in total agreement with the Defendant's position and adopt its explanation. The Plaintiffs mitigated the FIRREA-caused loss of borrowing capacity in part by such infusions of equity capital. From the point of view of Plaintiffs, other than the bank, this was an investment they were gong to make somewhere and on which they would have expected an adequate return. They made the investment in Bank United and not only restored borrowing capacity, but provided that much cash for the Bank's growth.

To award the principal amount of such capital infusions would be replacing an investment Plaintiffs still have or have transferred. To award a hypothetical rate of return on such principal amount would be a duplication of whatever return the infusing Plaintiffs have already received from their investment.

[78]

The reasons just stated apply directly to Plaintiffs' motion filed on January 3, 2002 to amend findings and judgment. There was included with that motion a simultaneous, separate motion to reopen the record for additional evidence. The ruling just made on the motion to amend findings and judgment makes irrelevant the additional evidence which Plaintiff seeks to include in the trial record, and consequently that separate motion to reopen the record will also be denied.

In addition to the two Plaintiff motions, the Defendant filed on February 22 a motion to strike portions of the appendix to Plaintiffs' motions filed on January 23. Given the rulings already made, the Defendant's motion is moot in that it has no bearing on any issue still in the case.

Consequently, Defendant's motion filed on February 22 will be denied as moot.

Ladies and gentlemen, that concludes the ruling. Are there other matters which should be discussed before we adjourn today? All right. Thank you all again. To everyone present, I wish you well and I hope that our paths cross again. Court will be in recess.

THE CLERK: All rise.

(Whereupon, at 1:02 p.m., the hearing was concluded.)

[79]

REPORTER'S CERTIFICATE

DOCKET NO.: 95-473-C

CASE TITLE: BANK UNITED OF TEXAS v. U.S.

HEARING DATE: April 16, 2002

LOCATION: Washington, DC

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the United States Court of Federal Claims.

Date: April 16, 2002

CARMEN SMITH
Official Reporter
Heritage Reporting Corporation
Suite 600
1220 L Street, N.W.
Washington, D.C. 20005-4018

APPENDIX D

94-473C

3/19/99

****

Bank United of Texas, FSB, et al.

v.

The United States

****

Walter B. Stuart IV, Vinson & Elkins L.L.P., Houston, Texas, with whom were John D. Taurman, Alden L. Atkins, Joseph E. Hunsader, David T Hedges, Jr., James A. Reeder, Jr., and Christopher H. Meakin, for plaintiffs.

John J. Hoffman, with whom were John Davidovich, Katherine Kelly, Luke Levasseur, Bill Donovan, Andrea Gribble, Jeanne E. Davidson, Assistant Director, David M. Cohen, Director, Commercial Litigation Branch, Civil Division, and Frank W. Hunger, Assistant Attorney General, United States Department of Justice, Washington, D.C., for defendant.

OPINION AND ORDER

SMITH, Chief Judge.

This case is before the court on plaintiffs' motion for partial summary judgment as to liability and defendant's motion for a ruling on defendant's affirmative defense of accord and satisfaction. For the reasons discussed below, plaintiffs' motion for partial summary judgment as to liability is granted, and plaintiffs are granted summary judgment as to the affirmative defense of accord and satisfaction.

The case deals with the acquisition of a failed thrift, United Savings Association of Texas (Old United), from the Federal Savings and Loan Insurance Corporation (FSLIC) by a newly-formed thrift, now known as Bank United, and its holding companies in December 1988.[1]

Plaintiffs contend that the passage of Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub.L. 101-73, 103 Stat. 183, and its implementing regulations, breached the following promises by the government to plaintiffs: (1) to allow Bank United to operate under special modified capital requirements; (2) to count $110 million of subordinated debt as regulatory capital; and (3) to treat supervisory goodwill as regulatory capital. These promises, according to plaintiffs, were set forth in the contract documents: the Acquisition Agreement, signed by the FSLIC and United Savings Association, dated December 30, 1988; the Assistance Agreement, signed by the FSLIC, United Savings, USAT Holdings, Hyperion Holdings and Hyperion Partners, dated December 30, 1988; the Forbearance Letter from the Federal Home Loan Bank Board, dated February 15, 1989; FHLBB Resolution No. 88-1535, dated December 30, 1988, and the Regulatory Capital Maintenance Agreement, signed by the FSLIC, United Savings, USAT Holdings, Hyperion Holdings and Hyperion Partners, dated December 30, 1988.

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[1] At the time of the transaction, Bank United, then known as United Savings Association of Texas FSB (and later as Bank United of Texas FSB) was owned by USAT Holdings, Inc. Hyperion Holdings Inc., in turn, owned 100 percent of the voting stock of USAT Holdings Inc. Hyperion Partners L.P. owned 100 percent of the stock of Hyperion Holdings. In 1996, USAT Holdings changed its name to Bank United Corp., and Hyperion Holdings Inc. was merged with and into Bank United Corp. Consequently, the plaintiffs are Bank United, Bank United Corp., and Hyperion Partners L.P.

This case has been governed by special procedures established in the wake of the Supreme Court's decision in *United States v. Winstar*, 116 S.Ct. 2432 (1996). As part of that process, the court heard argument on a broad range of issues which had been raised in four of the *Winstar*-related cases. This culminated in the court's opinion in *California Federal*, 39 Fed. Cl. 753 (1997). As a result of that opinion, the court ordered the government to show cause, in light of that opinion, why summary judgment should not be entered in cases, such as this one, where a motion for partial summary judgment as to liability had been filed. This generated a round of responsive briefing in an attempt to narrow further the issues left unresolved by the *California Federal* decision and by the Winstar decisions of the Supreme Court, the Federal Circuit, and the Court of Federal Claims.

In response to the court's show cause order, defendant identified two issues that remained unresolved in light of the *California Federal* opinion. The first is defendant's affirmative defense of accord and satisfaction, which defendant contends resolved any dispute regarding the government's obligation to allow plaintiffs to include subordinated debt as regulatory capital. The second is defendant's contention that the government did not breach any alleged capital forbearance because it never took regulatory action against the bank. Plaintiffs do not dispute that these two issues are still pending. The court will discuss each in turn.

AFFIRMATIVE DEFENSE OF ACCORD AND SATISFACTION

In July 1990, Bank United's holding company requested regulatory approval from the Office of Thrift Supervision of a transaction designed to exchange its subordinated debt—now worthless as regulatory capital—for notes which would qualify as regulatory capital. As described by Lewis S. Ranieri, Chairman and Chief Executive Officer of the holding company in his July 13, 1990 letter requesting approval of the transaction:

The proposed transaction involves the exchange of 15% Subordinated Capital Notes due 1999 (the "Subordinated Notes") issued by United Savings Association of Texas FSB ("USAT") for 15¾% Senior Notes (the "Senior Notes") to be issued by USAT Holdings Inc. ("USAT Holdings"), the sole stockholder of USAT (the "Exchange"). As a result of the Exchange, USAT Holdings will hold all of the outstanding Subordinated Notes and the existing holders of Subordinated Notes will hold the same amount and proportion of Senior Notes as they had held of Subordinated Notes. At the same time, the Subordinated Notes will be amended to permit prepayment without penalty.

The Exchange would replace up to $110 million of debt that is basically useless as capital—and that drains an estimated $6 million per year from USAT's earnings—with an equal amount of core capital, leading to institutions with core capitalization and profitability. The result would also accomplish the intention of the parties in December 1988, *i.e.*, the $110 million would count as capital for all regulatory purposes.

On August 20, 1990, the OTS approved the transaction as set forth in Mr. Ranieri's letter. As defendant notes, at the time the request was made (and ultimately approved), FIRREA had been passed and the subordinated debt could no longer be included in core capital. Hence, according to the government, if any breach did occur by the passage of FIRREA, "that breach was cured when OTS allowed plaintiffs to exchange the subordinated debt." Def.'s 120-Day Resp. to Pls.' Mot. for Partial Summ. J. at 21.

"An accord and satisfaction operates to extinguish, discharge, or terminate an existing right." *Westerhold v. United States*, 28 Fed. Cl. 172, 174 (1993). In order to prove a valid accord and satisfaction, the defendant must show the following: (1) proper subject matter; (2) competent minds; (3) a meeting of the minds; (4) consideration; and (5) the acceptance of payment or performance in satisfaction of a claim or demand which is a bona fide dispute. *Id.* 174-75.

Defendant contends that all elements are present here. Plaintiffs made an offer, which was accepted, and the intention of the parties to settle the dispute is clearly demonstrated in Mr. Ranieri's letter to the OTS, which states that this was an effort to "accomplish the intention of the parties in December 1988, *i.e.*, the $110 million would count as capital for all regulatory purposes." Moreover, defendant contends that, since the agreement evidenced no reservation of rights, plaintiffs cannot now assert a claim for damages, because such reservation must be manifestly and explicitly set forth in the settlement or modification. *Cannon Constr. Co. v. United States*, 162 Ct. Cl. 94, 101, *aff'd* 319 F.2d 173, 177 (Ct. Cl. 1963).

As is becoming an all too familiar pattern in the *Winstar* related cases, defendant cites settled legal rules and attempts to transmute the facts to satisfy the legal rules. Just as one cannot turn iron into gold, one cannot turn facts that flatly contradict the existence of an accord and satisfaction into facts that establish one. Plaintiffs argue that three of the five requirements are not met in this case: there is no meeting of the minds; there is no consideration; and there is no acceptance of payment or performance in exchange for a claim or demand in bona fide dispute. Moreover, as plaintiffs point out, the forbearance agreement and Regulatory Capital Maintenance Agreement prohibited Bank United from prepaying the subordinated debt without regulatory approval, and OTS approval was required by regulation for certain aspects of the transaction. Hence, plaintiffs were requesting approval as required by contract and regulation.

Simply put, there is no evidence in the documents or elsewhere than that these were anything other than a regulatory request and approval. The court need not look at plaintiffs' affidavits, which defendant contends are self-serving, to come to that conclusion. Nothing in the documents themselves suggests that plaintiffs and defendant came to a meeting of the minds to settle a bona fide dispute over the treatment of subordinated debt as regulatory capital. Further, there is no suggestion in the letters that any consideration

was exchanged. Indeed, the linchpin of the defendant's argument that the parties effected an accord and satisfaction—Mr Ranieri's statement in the request for approval that "[t]he result would also accomplish the intention of the parties in December 1988, *i.e.*, the $110 million would count as capital for all regulatory purposes"—actually suggests mitigation, not accord and satisfaction. The sentence indicates that there is no bona fide dispute as to the parties' respective rights and obligations, and that plaintiffs are seeking regulatory approval to fill a capital hole which would be otherwise unnecessary had the government not breached its contract.[2]

The fact that the government is the breaching party and also a regulator does not transform regulatory action necessitated by the breach into a contractual accord and satisfaction.[3] Simply put, plaintiffs needed to obtain regulatory approval to engage in a transaction designed, in part, to put Bank United in the same capital position *vis a vis* the $110 million that they were entitled to under their contract prior to the passage of FIRREA. It does not suggest that this regulatory exchange operated as a waiver of any claims against the

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[2] The affidavit of Billy Wood, the Office of Thrift Supervision (OTS) examiner, regarding his interpretation of Mr. Ranieri's statements, does nothing to alter the court's conclusion. His affidavit states that the OTS approval "would resolve the issue/problem arising from the fact that FIRREA precluded the use of subordinated debt as regulatory capital." Not surprising, since this was the stated reason in Mr. Ranieri's letter. Tellingly, though, is what the affidavit does not say: Mr. Wood gives no indication that this approval was conditioned or bargained for in exchange for the release of plaintiffs' claims.

[3] The government might suggest that this is inconsistent with the court's *California Federal* decision, because it continues to insist that the court has determined that mere regulatory approval creates a binding contractual commitment by the government. The court has never indicated that regulatory approval alone creates a contract.

government for damages that may have resulted from the breach. While this transaction certainly may be relevant to the quantum of damages, its approval is not an accord and satisfaction. Further, it is irrelevant that there was no reservation of rights in the documents of claims emanating from the breach since the documents do not evidence any accord and satisfaction. For these reasons, plaintiffs are granted summary judgment as to defendant's affirmative defense of accord and satisfaction.

NO BREACH OF THE CAPITAL FORBEARANCE

Defendant argues that, because the government allegedly never took regulatory action against Bank United for failure to meet capital requirements, there was no breach. As the government states: "If the Government did not exercise its authority to take regulatory action against the bank for the bank's failure to meet certain regulatory capital requirements, then the Government upheld its end of the 'bargain' and never breached its promise." Def.'s Resp. to the Court's Order to Show Cause at 22.

Plaintiffs argue, first, that the government did take regulatory action, and second that it is irrelevant regardless. Plaintiffs point to OTS Thrift Bulletin 38-2, which eliminated capital forbearances such as the one in this case. Plaintiffs also argue that OTS did take regulatory action against the bank in December 1990, by requiring Bank United to infuse additional capital to meet FIRREA's capital ratios. This action would not have been necessary had the capital forbearance been honored.

More importantly, though, it does not matter that regulators took no enforcement action against Bank United. This is true because the government did repudiate its duty to forbear from enforcing existing regulatory capital requirements so long as Bank United met the modified ones set forth in the forbearance letter. Bank United met FIRREA's requirements because the regulators ordered it to do so, notwithstanding the contract. As plaintiffs put it: "If the government's argument were right, Bank United should have defied FIRREA

and the orders of the regulators and operated at the lower capital ratios set forth in the Capital Forbearance. Had it done so, Bank United would have suffered prompt enforcement action, disruption and seizure. There is no legitimate reason to require a plaintiff to put its entire existence into peril in the face of the government's breach." Pls.' Resp. to Def.'s Show Cause Mem. at 12. The point is that the capital forbearance operates as a modified capital requirement, which plaintiffs bargained for and which plaintiffs could not rely upon anymore. The fact that plaintiffs were able to keep regulators somewhat at bay notwithstanding the breach does not mean that the government honored its promise.[4] Plaintiffs are entitled to damages that resulted from the need to meet the enhanced capital requirements that they otherwise would not have had to meet had the government honored the capital forbearance promise. The issue is not whether there was a breach, but whether, and to what extent, damages flowed from it. This requires a trial.

Lastly, defendant makes a recently articulated challenge to what it considers plaintiffs' improper interpretation of the scope of the capital forbearance. In its second show cause brief, defendant spells out its interpretation of the forbearance as follows:

The plain language of the forbearance shows that it would be triggered only when:

1) the thrift has failed to meet regulatory capital requirements;

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[4] By the government's logic, if an insurance company told a policy holder that it would not honor its contract to provide insurance, and the policy holder ultimately never had need to file a claim, then there could be no breach. This, of course, makes no sense. The question in this example, as in this case, is whether that repudiation of the contract caused the non-breaching party damages.

2) the failure is caused "solely" by losses on non-covered assets (or certain liabilities) acquired from the failed thrift; and

3) the thrift meets the minimum "percentage floor" set forth in the forbearance letter for the applicable time period.

Def.'s Resp. to Pls.' Prop. Orders at 15. Thus, according to defendant, if the thrift fails to meet regulatory capital requirements, one must determine first if it was caused solely by the specified assets and liabilities and then whether it meets the percentage floor set forth in the forbearance letter. Plaintiffs make two criticisms of defendant's argument, both valid. First, plaintiffs point out that the government construction of the forbearance ignores the provision that the government will forbear from enforcing existing capital regulations if the deficit is caused solely by "the assumption of the liabilities of the Acquired Institution as of the Effective Date." Since the forbearances, it comes as no surprise, were designed to enable Bank United to survive the absorption of the liabilities of Old United, and continue leveraging notwithstanding the assumption of liabilities, it seems apparent that the modified capital standards in the forbearance letter are operative at all times, and require no separate showing. This certainly is buttressed by the actions of the parties. There is no evidence, for instance, that Bank United had to make a showing that the lower capital levels were caused solely by the assumed liabilities of Old United. Instead, regulators accepted that Bank United merely had to meet the capital requirements set forth in the forbearance letter, without any independent and separate showing. *See, e.g.*, May 8, 1989 OTS Report of Examination, which explains the forbearances purely in terms of meeting the percentages set forth in the forbearance letter, without any reference to the mandatory showing defendant now contends was required.

Second, as plaintiffs make clear, even were the court to accept defendant's more recent and limited understanding of the scope of the forbearance, which the court does not, that would only go to the issue of damages, and not, once again,

to the issue of whether plaintiffs had a contractual forbearance right breached by the passage of FIRREA.

CONCLUSION

Upon consideration of plaintiffs' short-form motion for partial summary judgment on liability, defendant's motion for a ruling upon its affirmative defense of accord and satisfaction, and the parties' submissions in connection with those motions, as well as the show cause filings generated after the court's decision in *California Federal*, and for the reasons set forth in this opinion and the court's opinion in *California Federal*, it is hereby

ORDERED that plaintiffs' motion for partial summary judgment is granted and that plaintiffs are granted summary judgment on liability for breach of contract in Count 1 of the Complaint; and it is further

ORDERED that, with regard to defendant's motion for a ruling upon its affirmative defense of accord and satisfaction, defendant's motion for summary judgment as to the affirmative defense is denied, and plaintiffs are granted summary judgment as to that defense; and it is further

ORDERED that, pursuant to RCFC 77(f), the Omnibus Case Management Order (September 18, 1996) and the Priority Cases Pretrial Scheduling Order (April 2, 1997), that this case be reassigned to Judge James T. Turner as Trial Judge for all further proceedings, except for requests for clarification of this opinion, which will be considered by Chief Judge Smith, and except for defendant's pending motion for enforcement of this court's order of February 3, 1999, which will be considered by Discovery Judge Miller.

IT IS SO ORDERED.

LOREN A. SMITH

CHIEF JUDGE

APPENDIX E

United States Court of Federal Claims.

BANK UNITED OF TEXAS FSB, et al., Plaintiffs,

v.

The UNITED STATES, Defendant.

No. 95-473C.

July 2, 1999.

ORDER

SMITH, Chief Judge.

On March 19, 1999, the court issued an opinion and order in this case. Defendant has filed a motion to clarify or modify the court's order. As has become common in *Winstar*-related cases, this motion has generated briefing beyond what is anticipated under the court's rules: plaintiffs filed an unopposed motion for leave to file a surreply in opposition to defendant's motion, and defendant filed an unopposed motion for leave to file a surrebuttal in support of its motion. The court grants both motions for leave, the Clerk is directed to file plaintiffs' surreply and defendant's surrebuttal briefs this date, and the court has considered both in resolving the pending motion.

Defendant makes two principal objections which, depending upon the court's understanding of the March 19, 1999 opinion, makes it either a request for a clarification or a request for a modification. In determining that the capital forbearance constituted a contractual promise which was breached by FIRREA and its implementing regulations, the court commented on the purpose of the forbearance and its scope, and rejected defendant's interpretation of the scope of that forbearance. If the court's statements about the scope of the forbearance were intended only as observations, based on

the court's review of an incomplete record, then defendant wishes the court to clarify that such scope issues have not been resolved and are, properly, to be considered by the Trial Judge as part of the damages phase of the litigation. If, however, the court's statements were meant to resolve the scope of the forbearance, then defendant believes that the court should reconsider that holding, and modify the opinion accordingly.

The court believes neither a clarification nor a modification as requested by defendant is required. The capital forbearance at issue is unambiguous on its face, and the court need not resort to extrinsic evidence outside the language of the forbearance letter itself to come to that conclusion. Bank United was entitled to enforce the promise contained in the forbearance letter, which permitted it to meet modified capital requirements in lieu of regulatory capital requirements, for a period of ten years.

As a policy matter, the fact that the capital forbearance operated to give Bank United a ten-year forbearance from the regulatory capital requirements may not have been ideal. The court, however, is not making a policy judgment; it is interpreting the plain language of a contract. Indeed, defendant's proffered contract interpretation, on pp. 8-9 of its reply brief, may make more regulatory sense, and if the court were a regulator it may well have strived to draft the forbearance letter as defendant now wishes it to read. It is not, however, what the actual forbearance letter paragraph says, and since the letter does not raise any ambiguities that require the court to go beyond its four corners, the court will not do so.

The court notes briefly that, to the extent the court referenced extrinsic evidence, specifically the 1989 OTS Report of Examination, it was only to show that the regulators attached the same meaning to the forbearance, a meaning dictated by the words of the forbearance letter. The plain language of the forbearance, however, is clear without reference to the OTS Report.

Accordingly, defendant's motion to clarify or modify the court's order and opinion dated March 19, 1999 is denied. The court reaffirms its holding in that opinion that, pursuant to the terms of the forbearance letter, Bank United was entitled to operate at the modified capital levels set forth in the letter, for a period of ten years, and that the government breached its agreement with plaintiffs when it set the new FIRREA-based capital requirements.

APPENDIX F

[Filed Dec. 12, 2003]

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

02-5132, -5137

BANK UNITED, BANK UNITED CORP,
and HYPERION PARTNERS L.P.,

Plaintiffs-Appellants,

v.

UNITED STATES

Defendant-Cross Appellant.

ORDER

A combined petition for panel rehearing and for rehearing en banc having been filed by the APPELLANTS and the petition for rehearing having been referred to the panel that heard the appeal, and thereafter the petition for rehearing en banc having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for panel rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the petition for rehearing en banc be, and the same hereby is, DENIED.

The mandate of the court will issue on December 19, 2003.

FOR THE COURT
/s/
Jan Horbaly
Clerk

Dated: December 12, 2003

cc: Walter B. Stuart
David M. Cohen

BANK UNITED V US, 02-5132, -5137
(CFC – 95–CV–473)

Note: Pursuant to Fed. Cir. R. 47.6, this order is not citable as precedent. It is a public record.